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EXEMPTION IMPAIRING LIENS UNDER BANKRUPTCY CODE SECTION 522(f): ONE STEP FORWARD AND ONE STEP BACK

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INTRODUCTION

There has always been a fundamental tension between the frequently recited twin goals of the consumer bankruptcy system: a fresh start for financially beleaguered debtors and equality of distribution for creditors.[1] Additionally, there has always been a fundamental disagreement over the extent to which the bankruptcy law should defer to prebankruptcy state law rights and entitlements.[2] Historically, the two primary ingredients in the bankruptcy fresh start have been discharge from debts[3] and exemptions.[4] In a conscious effort to make that relief more

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1. *See* Elizabeth Warren, *A Principled Approach to Consumer Bankruptcy*, 71 AM. BANKR. L.J. 483 (1997) (pointing out that these two "abstract principles" alone provide precious little guidance for specific legislative proposals for reform of the system). *See generally* Charles G. Hallinan, *The "Fresh Start" Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretive Theory*, 21 U. RICH. L. REV. 49 (1986) (providing an in-depth historical overview of how societal attitudes to debtor relief and creditor protection have manifested themselves in the evolution of American bankruptcy legislation).

2. *See generally* Lawrence Ponoroff, *Enlarging the Bargaining Table: Some Implications of the Corporate Stakeholder Model for Federal Bankruptcy Proceedings*, 23 CAP. U. L. REV. 441, 444 n.11 (1994).

3. *See generally* John C. McCoid, II, *Discharge: The Most Important Development in Bankruptcy History*, 70 AM. BANKR. L.J. 163 (1996); Charles J. Tabb, *The Historical Evolution of the Bankruptcy Discharge*, 65 AM. BANKR. L.J. 325 (1991) (tracing the history of the discharge in American bankruptcy law).

4. *See In re* Eldridge, 22 B.R. 218, 222 (Bankr. D. Me. 1982) ("Providing debtors the means to support themselves enables debtors to be productive members of society, enhances human dignity, and avoids increased public assistance expense and the oft-accompanying social costs. Clearly exemption statutes further an important public purpose."); Lawrence Ponoroff & F. Stephen Knippenberg, *Debtors Who*

meaningful,[5] the Bankruptcy Reform Act of 1978,[6] now commonly referred to as the "Code" or the "Bankruptcy Code," contained a new provision allowing debtors to avoid certain liens that interfere with their ability to enjoy certain exemptions.[7] Although Code section 522(c)(2)[8] provides that a debt secured by an *unavoidable* lien is excepted from the general rule that exempt

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Convert Their Assets on the Eve of Bankruptcy: Villains or Victims of the Fresh Start?, 70 N.Y.U. L. REV. 235, 254 (1995) (identifying traditional justifications for exemptions as ranging "from providing the debtor with the physical wherewithal necessary to return to economic viability to privatizing the burden of ensuring that the debtor's family has the property necessary for its subsistence"). For a brief historical sketch of the development of exemptions for debtors' property, see Douglas E. Deutsch, Note, *Exemption Reform: Examining the Proposals*, 3 AM. BANKR. INST. L. REV. 207, 210-13 (1995). *See also* Frank R. Kennedy, *Limitation of Exemptions in Bankruptcy*, 45 IOWA L. REV. 445, 446-68 (1960) (discussing how the development of exemption legislation in the United States mirrored the impact of a developing social conscience in the nineteenth century to protect the family of the debtor from penury).

Of course, there are numerous other provisions of the Bankruptcy Code that also directly or indirectly implement the fresh start policy in consumer cases, ranging from the right of individual debtors under Code section 722, 11 U.S.C. § 722 (1994), to redeem tangible personal property from a lien securing a dischargeable consumer debt to the priority in distribution accorded to dischargeable tax claims under Code section 507(a)(8), 11 U.S.C. § 507(a)(8) (1994). *See generally* Douglass G. Boshkoff, *Fresh Start, False Start, or Head Start?*, 70 IND. L.J. 549 (1995) (identifying the prohibition in Code section 525, 11 U.S.C. § 525 (1994), against discriminatory treatment based solely on a bankruptcy filing, along with the discharge and the protection of exempt property, as the primary components of the fresh start).

5. *See* Hallinan, *supra* note 1, at 86-89 (describing the 1978 Bankruptcy Code as representing the high watermark in terms of a consumer protectionist orientation in federal bankruptcy law); Doug Rendleman, *The Bankruptcy Discharge: Toward a Fresher Start*, 58 N.C. L. REV. 723, 750-60 (1980) (discussing the new Bankruptcy Code's expansive approach to fresh start). In *Deel Rent-A-Car, Inc. v. Levine*, 721 F.2d 750, 757 (11th Cir. 1983), the court commented on the adoption of new substantive and procedural protections relating to exemptions as part and parcel of the 1978 Bankruptcy Code's "new policy of protection for the debtor in a bankruptcy proceeding."

6. Pub. L. No. 95-598, 92 Stat. 2549 (1978) (effective Nov. 6, 1978) (codified as amended in scattered sections of 11 U.S.C.). The Bankruptcy Code was subsequently and most comprehensively amended in 1984, 1986, and 1994. It remains the governing substantive law of bankruptcy to the present.

7. *See* Veryl Victoria Miles, *A Debtor's Right to Avoid Liens Against Exempt Property Under Section 522 of the Bankruptcy Code: Meaningless or Meaningful?*, 65 AM. BANKR. L.J. 117, 123-24 (1991) (pointing out that the debtor's avoidance powers under section 522 make the exemptions more meaningful by eliminating secured creditors' postbankruptcy rights to foreclose, and thus deprive the debtor of her property, and, concomitantly, removing the pressure the debtor would otherwise be under to reaffirm the debt in order to retain the property); *see also* Belknap v. Henderson (*In re* Henderson), 168 B.R. 151, 156 (W.D. Tex. 1993), *aff'd*, 18 F.3d 1305 (5th Cir. 1994) (noting that section 522(f) implements the legislative will by assuring that "debtors gain a fresh start in their financial lives").

8. 11 U.S.C. § 522(c)(2) (1994).

property is not liable during or after the bankruptcy case for any debt that arose prior to the commencement of the case, Code section 522(f)[9] permits debtors to avoid judicial liens and nonpossessory, nonpurchase-money liens on various categories of consumer and business-related collateral to the extent those liens impair an exemption to which the debtor would otherwise have been entitled.[10]

After surviving an early constitutional challenge,[11] and after a lengthy period of enormous uncertainty and disagreement over when a lien would be deemed to impair an interest of the debtor in exempt property[12] and, accordingly, the extent to which a "qualifying lien"[13] could be avoided,[14] it seemed that with the

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9. 11 U.S.C. § 522(f) (1994).

10. As originally enacted, section 522(f) provided as follows:

> 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 a 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.

11 U.S.C. § 522(f) (1978).

For reference to the amendments made to section 522(f) in 1994, which include renumbering of subsection (f)(1) and (f)(2) as subsections (f)(1)(A) and (f)(1)(B), see *infra* note 133.

11. *See infra* text accompanying notes 38-43.

12. *See infra* Part I.B.

13. The term "qualifying lien" is used to refer to either one of the two types of liens described in section 522(f)(1): judicial liens or nonpossessory, non purchase-money security interests.

14. The operation of section 522(f) is discussed and illustrated in Part II.A. *See infra* text accompanying notes 95-123. One of its principal effects, however, was to overrule a line of court of appeals cases that took the position that a lien did not "impair" an exemption, and therefore was not subject to avoidance under section 522(f), unless the debtor had equity in the property over and above the sum of all senior nonavoidable liens. The corollary of that view was that, even to the extent such equity existed, avoidance would be limited to the lesser of the monetary value of the equity or the amount of the exemption. *See, e.g.*, American Cast Iron Pipe Co. v. Wrenn (*In re* Wrenn), 40 F.3d 1162 (11th Cir. 1994); First Nat'l Bank v. Menell (*In re* Menell), 37 F.3d 113 (3d Cir. 1994); City Nat'l Bank v. Chabot (*In re* Chabot), 992 F.2d 891 (9th Cir. 1993); Wachovia Bank & Trust Co. v. Opperman (*In re* Opperman), 943 F.2d 441 (4th Cir. 1991). Because the undersecured portion of the lien remained as an encumbrance on the property, the debtor was deprived of the benefit of future

Bankruptcy Reform Act of 1994 ("1994 Amendments"),[15] Congress had finally eliminated the necessity for protracted litigation over the interpretational niceties surrounding section 522(f). Specifically, section 303 of the 1994 Amendments incorporated into section 522(f) a simple arithmetic formula for determining the extent to which the debtor's interest in exempt property is impaired.[16] Lamentably, however, bending to special interest pressure from long-time opponents of the debtor avoiding powers of section 522(f),[17] at the same time Congress cleared up one source of uncertainty that had plagued the system, it bestowed upon us the following legal and linguistic nightmare:

> 522(f)(3) In a case in which State law that is applicable to the debtor—
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> (A) permits a person to voluntarily waive a right to claim exemptions under subsection (d) or prohibits a debtor from claiming exemptions under subsection (d); and
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> (B) either permits the debtor to claim exemptions under State law without limitation in amount, except to the extent that the debtor has permitted the fixing of a consensual lien on any property or prohibits avoidance of a consensual lien on property otherwise eligible to be claimed as exempt property;
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> the debtor may not avoid the fixing of a lien on an interest of the debtor or a dependent of the debtor in property if the lien is a nonpossessory, nonpurchase-money security interest in implements, professional books, or tools of the trade of the debtor or a dependent of the debtor or farm animals or crops of the debtor or a dependent of the debtor to the extent the value of such implements, professional books, tools of the trade, animals, and crops exceeds $5,000.[18]

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appreciation in the property, whether due to market factors or principal reductions, presuming that immediate postbankruptcy foreclosure did not render the issue moot. *See generally* Margaret Howard, *Multiple Judicial Liens in Bankruptcy: Section 522(f)(1) Simplified*, 67 AM. BANKR. L.J. 151, 169-72 (1993).

15. Pub. L. No. 103-394, 108 Stat. 4106 (codified as amended in scattered sections of 11 U.S.C., 12 U.S.C., 18 U.S.C., and 28 U.S.C.) [hereinafter "1994 Amendments"].

16. *See infra* Part II.A.

17. *See infra* text accompanying notes 159-66.

18. 1994 Amendments § 310. This provision also added a proviso to section 522(f)(1) making the debtor's avoiding power expressly subject to this limitation. At the same time, section 304 of the 1994 Amendments carved out an exception to the debtor's power to avoid judicial liens that secure debts "to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child" under section 522(f)(1)(A)(i). The legislative history indicates that this

Given the somewhat blurry line separating consumer and small-business debtors,[19] the need for a provision similar to section 522(f)(3) is not nearly as fatuous as the contorted language of the statute might lead one to believe.[20] Some states do not appropriately limit a debtor's ability to exempt tools of the trade collateral, which can lead to inequitable and nonuniform results in bankruptcy situations. Indeed, because of these inequities and disuniformity, there is also room for legitimate debate over the extent to which, if at all, state law ought to control exemption policy in bankruptcy.[21] Ultimately, however, as presently drafted, section 522(f)(3) represents an unprincipled and indefensible piece of legislation that promises to delay the prompt administration of bankruptcy cases and further erode the effectiveness of an already overburdened consumer bankruptcy system.

In an effort to untangle the jumble and rationalize these provisions, Part I of this article briefly recounts the early history of section 522(f). Part II examines the developments and

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limitation was intended to supplement the reach of *Farrey v. Sanderfoot*, 500 U.S. 291 (1991), although it is not clear that the language of the statute effectively accomplishes that result. *See* Margaret Howard, *Avoiding Powers and the 1994 Amendments to the Bankruptcy Code*, 69 AM. BANKR. L.J. 259, 278-79 (1995); *see also* Darilyn T. Olidge, *Divorce Liens Under Section 522(f) of the Federal Bankruptcy Code: Resolving Tensions Between Family and Bankruptcy Law*, 67 N.Y.U. L. Rev. 879 (1993) (calling for reform in connection with avoidability of divorce liens and property settlement obligations). Section 414 of Senate Bill 1301, the Consumer Bankruptcy Reform Act of 1997 proposes to clarify at least the language of subsection (f)(1)(A)(ii)(II), which, as presently drafted, is a legal non sequitur. *See generally infra* note 22.

19. *See generally* TERESA A. SULLIVAN ET AL., AS WE FORGIVE OUR DEBTORS 119 (1989) (noting that a significant portion of the debt in individual bankruptcy cases is actually *business* debt); Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 342 (1993) ("The line between a small business debtor and an individual debtor is often only a formal distinction. Individuals in bankruptcy are disproportionately the owners of small businesses, and businesses in bankruptcy are overwhelmingly smaller businesses that are not publicly traded." (footnotes omitted)).

20. *See In re* Clifford, 222 B.R. 8 (Bankr. D. Conn. 1998) (denying the bankruptcy trustee's objection to the debtor's claimed tools of the trade exemption based on the dollar value ceiling in Connecticut's tools of the trade exemption); *see also infra* text accompanying notes 127-28.

21. For a particularly strong argument in favor of mandatory uniform federal bankruptcy exemptions, see 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). *See also infra* text accompanying notes 310-11.

considerations that prompted the 1994 Amendments to section 522(f), and evaluates the wisdom of that legislation. Part III reviews the case law attempting to grapple with this new provision, and concludes that the formulation is unworkable. Accordingly, Part IV begins by offering, for the short-term, a judicial interpretation of section 522(f)(3) as presently constituted that is consistent with general Bankruptcy Code philosophy and methodology in construing provisions in derogation of the fresh start. It concludes, however, that section 522(f)(3) is hopelessly flawed and that the only sensible solution is to redraft the provision in a more balanced and intelligible fashion. Therefore, Part IV proposes, as a legislative solution to the morass wrought by the 1994 Amendments to section 522(f), an alternative formulation intended to promote more uniform application consistent with sensible policy goals, rather than purely special interest desires.

I. THE ORIGINS OF THE DEBACLE

Although the debate concerning whether the pendulum swung too far persists to the present and, indeed, has recently intensified,[22] there is no doubt that adoption of the Bankruptcy

22. Currently, the debate centers around the issue of whether, for the first time in American bankruptcy jurisprudence, a debtor should be deprived access to liquidation and discharge when an analysis of the debtor's financial situation reveals an ability to pay a portion of her debts from future income. So-called means testing or needs-based bankruptcy was specifically rejected by the National Bankruptcy Review Commission (also formed under authority of the 1994 Amendments), which issued its final report on October 20, 1997. *See* NATIONAL BANKRUPTCY REVIEW COMMISSION, BANKRUPTCY: THE NEXT TWENTY YEARS (1997). The report is available from the United States Government Printing Office or on the Internet at <http://162.140.225.1/ reporttitlepg.html>. For a revealing insider's look into the proceedings of the Commission's Consumer Bankruptcy Workshop, see Warren, *supra* note 1. However, even before the report was issued, and its contents widely known, Representatives Bill McCollum and Rick Boucher introduced the Responsible Borrower Protection Bankruptcy Act of 1997, H.R. 2500, 105th Cong. (1997), which, among other things, would establish a needs-based bankruptcy system. That system would calculate the amount of relief to which a debtor would be entitled according to a formula using the debtor's income and obligations to determine his or her ability to repay creditors, and would preclude use of chapter 7 by debtors whose annual income exceeded 75 percent of the national medium family income. On February 3, 1998, Representatives George Gekas and James Moran introduced the Bankruptcy Reform Act of 1998, H.R. 3150, 105th Cong. (1998), which contains similar limitations. House Bill 3150 was passed by the House in a partisan vote on June 10, 1998. Companion legislation to House Bill 2500, the Consumer Bankruptcy Reform Act of 1997, S. 1301, 105th Cong. (1997), was introduced in the Senate by Senators

Code in 1978 marked a significant shift in favor of consumer debtor relief in the precarious and elusive balance that American bankruptcy law has long sought to achieve between the fresh start for individual debtors and protection of the legitimate collection rights of creditors.[23] Among the new provisions enacted to promote the debtor's fresh start was section 522,[24] the exemption statute, which departed from pre-Code law in two important respects.[25] First, subject to the states' opt-out powers,[26] the statute contained a list of federal bankruptcy exemptions, which a debtor could elect to claim in lieu of her applicable state and other nonbankruptcy federal exemptions.[27]

Charles Grassley and Richard Durbin. While the Senate bill, which was passed on September 23, 1998 by a 97-1 vote, also incorporates means testing to determine whether some form of payment will be required, it would use a case-specific approach, reserving more discretion for the bankruptcy judge rather than the bright-line formulaic approach taken in the House bills. Therefore, a conference committee will consider both versions of the bill in an effort to work out a compromise bill before Congress is scheduled to adjourn in October. Although it never garnered significant support, it is worth noting that on the same day that House Bill 3150 was introduced, Representatives Jerrold Nadler and John Conyers introduced the Consumers Lenders and Borrowers Bankruptcy Accountability Act of 1998, H.R. 3146, 105th Cong. (1998). Although this bill also included certain provisions, such as a limitation on the homestead exemption, aimed at debtors who abuse the system, unlike the other pending legislation it also recognized the culpability of some creditors who, through irregular or reckless lending practices, have contributed to the dramatic increase in the number of consumer bankruptcy filings over the past several years.

23. *See* Warren, *supra* note 1, at 483 (observing that articulation of the competing goals of the system, fresh start and equality of distribution, are merely abstract principles that alone offer little by way of specific guidance in assessing what the positive rules of consumer bankruptcy law ought to provide).

24. 11 U.S.C. § 522 (1978).

25. The National Bankruptcy Act of 1898, ch. 541, § 6, 30 Stat. 544, 548 (repealed 1978) did not provide for specific exemptions for bankruptcy debtors; it simply recognized applicable state and nonbankruptcy federal exemptions. *See* Kennedy, *supra* note 4, at 451.

26. The opt-out arrangement contained in Code section 522(b), 11 U.S.C. § 522(b) (1994), permits the states, through passage of appropriate legislation, to restrict their citizens to the same exemptions from execution enjoyed by debtors who, for whatever reason, chose not to file bankruptcy. About two-thirds of the states have taken advantage of this opportunity. A state-by-state listing can be found in Brown, *supra* note 21, app. at 216-17. The opt-out provision represented a political compromise that, at the time, was seen as necessary to ensure passage of the bankruptcy reform legislation. *See* Ponoroff & Knippenberg, *supra* note 4, at 253 n.76.

27. *See* 11 U.S.C. § 522(d) (1994) (listing the Code's collection of federal bankruptcy exemptions). For non-federal bankruptcy exemptions see, for example, 38 U.S.C. § 3101 (1994) (veterans' benefits) and 22 U.S.C. § 4060 (1994) (foreign service retirement and disability).

Second, regardless of whether the debtor's exemptions were determined under state or federal law, subsection (f) provided a mechanism whereby certain categories of exempt property could be retained by the debtor even though encumbered by a valid prepetition lien,[28] which would, if otherwise not subject to avoidance by the trustee,[29] pass through the bankruptcy case unaffected.[30] Liens subject to the debtor's avoiding power under section 522(f) fall into two categories: judicial liens[31] and nonpossessory, nonpurchase-money security interests in the following:

> 1. Any household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held for the personal, family, or household use of the debtor or the debtor's dependents [collectively, the "Consumer Collateral"[32]];

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28. *See supra* note 10.

29. The trustee's avoiding powers, contained in Code sections 544, 545, 547-48, 11 U.S.C. §§ 544, 545, 547-48 (1994), are exercised for the benefit of the estate rather than the debtor. *See generally* Stephen E. Snyder & Lawrence Ponoroff, *The Avoiding Powers and Equitable Subordination*, Com. Bankr. Litig. (CBC) ch. 10. However, pursuant to Code section 522(g), 11 U.S.C. § 522(g) (1994), the debtor may exempt property recovered by the trustee under section 522(b), unless the transfer by the debtor was voluntarily concealed from the trustee. *See generally* Carey v. Heintz (*In re* Heintz), 198 B.R. 581 (B.A.P. 9th Cir. 1996) (discussing the interplay between Code section 551, 11 U.S.C. § 551 (1994), and exemptible property); Kempler v. Weis (*In re* Weis), 92 B.R. 816 (Bankr. W.D. Wis. 1988) (same).

30. *See* 11 U.S.C. § 522(c)(2) (1994); *see also infra* notes 35-43.

31. See 11 U.S.C. § 522(f)(1) (1994), providing that

> [n]otwithstanding any waiver of exemptions but subject to paragraph (3), the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien—(A) impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is a judicial lien, other than a judicial lien that secures a debt.

A "judicial lien" is defined in Code section 101(36), 11 U.S.C. § 101(36) (1994), as any "lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding."

32. Nonpurchase-money security interests in consumer collateral are rare. To begin with, Article 9 of the Uniform Commercial Code has always restricted a secured debtor's ability to encumber after-acquired consumer goods. *See* U.C.C. § 9-204(2) (1995). In addition, many states have supplemental consumer protection legislation that severely restricts a secured lender or seller's ability to take an effective security interest in consumer collateral. *See, e.g.*, UNIF. CONSUMER CREDIT CODE § 3.301, 7A U.L.A. 116 (1974). Furthermore, in 1985, the Federal Trade Commission made it a deceptive trade practice to take an interest in a wide variety of consumer goods as collateral for a consumer debt. *See* FTC Credit Practices Rule, 16 C.F.R. § 444.2(a)(4) (1998). Effective January 1, 1986, the Federal Reserve Board adopted a similar regulation applicable to banks. The FTC's rule, which is predicated on the belief that this type of collateral is usually taken for its leverage

2. Implements, professional books, or tools of the trade of the debtor or the debtor's dependents [collectively, the "Tools of the Trade Collateral"[33]]; and

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value rather than as a source for repayment, is actually derived from section 522(f). Although the categories of consumer collateral covered by the FTC rule and section 522(f)(1)(B)(i) are not entirely congruent, there is substantial overlap. As a consequence, situations where the debtor might need to take advantage of this avoiding power are far less likely to arise today than at the time the Code was first enacted. *See also infra* note 282.

33. *See In re* Thompson, 867 F.2d 416 (7th Cir. 1989) (discussing the relationship between the use of the phrase "tools of the trade" in Code section 522(d)(6), 11 U.S.C. 522(d)(6) (1978), and section 522(f)(2)(B), 11 U.S.C. §§ 522(f)(2)(B) (1978) (now 11 U.S.C. § 522(f)(1)(B)(ii) (1994)), and concluding that use of the phrase in the latter context should not be read as referring solely to the modest federal exemption). Items constituting "tools of the trade" will vary depending on the vagaries of state law. The general test, however, seems to be whether the item is "reasonably necessary," albeit not essential, to the debtor's ability to ply his chosen trade. For instance, in *Sun Country Distributors, Inc. v. Starkey*, 637 So. 2d 739 (La. Ct. App. 1994), the court determined that certain boat molds and a fiberglass spray unit were tools of the trade of a debtor engaged in the business of manufacturing fiberglass boats. Specifically, the court concluded that even though these items were not necessary to the debtor's trade because the boats could be made manually, it would be a severe hardship on the debtor to engage in his trade without this equipment. *See id.* at 741. Similarly, in *In re Siegal*, 214 B.R. 329 (Bankr. W.D. Tenn. 1997), the court concluded that a computer used by a lawyer to produce legal forms and documents was a tool of the trade for purposes of Tennessee's exemption law. *See also In re* Clifford, 222 B.R. 8 (Bankr. D. Conn. 1998) (noting that the tools of the trade exemption must be construed in accordance with modern technology and requires only that the item in question is necessary and be used in the debtor's business); *In re* Shipman, 167 B.R. 527 (Bankr. N.D. Ind. 1994) (concluding that it is the "use" to which the property is put rather than its size, shape, or value that determines whether it constitutes a "tool of the trade" within the meaning of section 522(f)). In contrast, in *In re Zais*, 202 B.R. 263 (Bankr. N.D. Ill. 1996), the debtor, a self-employed commodity trader, sought to claim an exemption under Illinois law for his membership on the Mid-American Commodity Exchange. Because the debtor could not engage in his trade without a personal seat on the exchange, he argued that the membership was reasonably necessary to his profession. Citing the federal interpretation of "tools of the trade" under section 522(d)(6), the court refused to adopt a broad definition of the term and limited its meaning to implements and instruments of modest value used to perform a particular task and not capital assets. *See id.* at 265; *see also* Dunivent v. Bechtoldt (*In re* Bechtoldt), 210 B.R. 599 (B.A.P. 10th Cir. 1997) (holding that a debtor may not multiply his tools of the trade exemption by claiming more than one occupation); First Bank of Chandler v. Watkins (*In re* Watkins), No. WO-97-028, 1997 Bankr. LEXIS 1505 (B.A.P. 10th Cir. Sept. 5, 1997) (concluding that items used by the debtor to earn income in a non-full-time occupation could not qualify under the Oklahoma exemption for tools of a trade); *In re* Wilson, No. 97-2390, 1997 U.S. Dist. LEXIS 13755 (E.D. La. Sept. 8, 1997) (holding livestock and dairy cows cannot constitute tools of a trade even though the debtor was a diary farmer); *In re* Erwin, 199 B.R. 628 (Bankr. S.D. Tex. 1996) (concluding that the relationship between a vehicle and the debtor's employment was "too tenuous" for the vehicle to qualify as a tool of the debtor's trade when the debtor used the car for personal and business purposes).

3. Professionally prescribed health aids for the debtor or the debtor's dependents ["Medical Appliances Collateral"].[34]

In all cases, to avoid a qualifying lien under section 522(f), the lien must have affixed to "an interest of the debtor in property" and must "impair an exemption" to which the debtor would otherwise have been entitled.

A. The Initial Constitutional Issue

Initially, section 522(f) was attacked on the ground that its application to consensual liens, properly created and perfected prior to the debtor filing a petition in bankruptcy, would constitute an uncompensated taking of property in violation of the Fifth Amendment.[35] Although the notion that unavoided liens "pass through" bankruptcy unaffected is a long-standing principle in American bankruptcy jurisprudence,[36] the proposition represents a much more complicated and nuanced subject.[37] In any event, if

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Thus, as a general rule, the burden is on the debtor to establish a full-time trade or profession and to demonstrate that the item is necessary for the debtor to continue in that trade. *See In re* Mackey, 209 B.R. 251 (Bankr. E.D. Okla. 1997). For present purposes, it is also important to note that there is no trend to expand the meaning of tools of the trade.

34. 11 U.S.C. § 522(f)(1)(B) (1994).

35. *See, e.g., In re* Thompson, 867 F.2d 416, 421-22 (7th Cir. 1989) (concluding that the constitutionality of section 522(f) is not an open question, but indicating that, under appropriate circumstances, even a prospective curtailment of property rights might fail under the Fifth Amendment); Commodore Consumer Discount Co. v. Barnett (*In re* Barnett), 35 B.R. 1 (Bankr. W.D. Pa. 1981) (determining that avoidance of nonposessory, nonpurchase-money liens perfected during the "gap period" between the time the Bankruptcy Reform Act of 1978 was enacted and the date it became effective was not unconstitutional); *In re* Cunningham, 17 B.R. 463 (Bankr. W.D. Ky. 1981) (holding that section 522(f) denied creditors due process insofar as it applied to security interests perfected prior to the enactment date of the Code).

36. *See* Dewsnup v. Timm, 502 U.S. 410, 418 (1992) (relying on Long v. Bullard, 117 U.S. 617 (1886)).

37. *See* Lawrence Ponoroff & F. Stephen Knippenberg, *The Immovable Object Versus the Irresistible Force: Rethinking the Relationship Between Secured Credit and Bankruptcy Policy*, 95 MICH. L. REV. 2234, 2266-73 (1997) (examining critically the axiom that liens pass through bankruptcy unaffected); James E. Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973, 1031 (1983) (suggesting that Congress has been accorded nearly complete freedom in formulating and enacting bankruptcy legislation). *But see infra* note 41 (suggesting that Congress's authority under the Bankruptcy Clause of the Constitution is subject to the Fifth Amendment's prohibition against uncompensated

the provisions of section 522(f) were not available, the debtor's postbankruptcy interest in exempt property would remain subject to the claims of secured creditors, thus rendering the exemption of little or no value in most cases.

When finally presented with the question of whether section 522(f) violated the Fifth Amendment, the Supreme Court managed to circumvent the issue. *United States v. Security Industrial Bank*[38] addressed a series of bankruptcy cases involving the application of the lien avoidance statute to pre-Code security interests. With Chief Justice Rehnquist writing for the majority, the Court concluded that Congress did not intend for section 522(f)(2)[39] to be applied retrospectively to property rights established prior to the enactment date of the Bankruptcy Code.[40] Although the Court in *Security Industrial Bank* avoided deciding the constitutional question, it did acknowledge in dictum its prior recognition of the principle that Congress's bankruptcy power is subject to the Fifth Amendment's general prohibition against the taking of private property without compensation.[41] Nevertheless,

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takings).

38. 459 U.S. 70 (1982).

39. 11 U.S.C. § 522(f)(2) (1978) (renumbered 11 U.S.C. § 522(f)(1)(B) by the 1994 Amendments).

40. *See Security Industrial Bank*, 459 U.S. at 80 (adopting the principle that bankruptcy statutes affecting property rights are to be construed as not applying retrospectively, in the absence of a strong indication of congressional intent to the contrary).

41. *See id.* at 75 (citing Louisville Joint Stock Land Bank v. Radford, 444 U.S. 164 (1979), as militating against the principle argued by the government that traditional property rights are entitled to no greater protection under the Takings Clause than traditional contract rights). This proposition has fueled the debate, which rages to this day, over whether the secured claimant's property interest in its collateral represents merely a priority claim to the *value* of the collateral as of the date of filing or a continuing *in rem* claim in the property itself. *See generally* Ponoroff & Knippenberg, *supra* note 37, at 2235 n.4, 2263-66. The resolution of that fundamental question carries with it enormous implications with respect to the ability of a debtor in bankruptcy to affect the rights of creditors holding prepetition liens against property of the estate. *Compare In re* Penrod, 50 F.3d 459 (7th Cir. 1995) (construing Code section 1141(c), 11 U.S.C. § 1141(c) (1994), as extinguishing the prefiling lien rights of creditors whose claims are dealt with in a plan of reorganization), *with* Cen-Pen Corp. v. Hanson, 58 F.3d 89 (4th Cir. 1995) (refusing to construe Code section 1327(c), 11 U.S.C. § 1327(c) (1994), which is similar in formulation to section 1141(c), as releasing the debtors' property from a prepetition mortgage even though the mortgagee had raised no objection to its treatment under the plan). The court in *Penrod* concluded that *Security Industrial Bank* was no bar to its interpretation of the statute since the aggrieved creditor could protect its interest in property from an uncompensated taking by appealing the order confirming a debtor's plan that does not provide for continuation of the lien. *See*

Security Industrial Bank did not unequivocally reject Congress's prospective authority to permit avoidance of even consensual liens in a bankruptcy proceeding.[42] Thus, the extent to which Congress retains the constitutional authority to affect property interests in bankruptcy remains an open question.[43]

B. The Era of State Control over When a Lien Impairs

Section 522(c)(2)[44] recognizes the well-accepted state commercial law principle that a debtor's exemption claim is subordinate to the claim of a creditor whose debt is secured by a consensual and otherwise nonavoidable lien against the property.[45] Thus, any such lien that is not avoidable under section 522(f) will survive the bankruptcy case and continue as a charge against the collateral.[46] In addition, until 1991, even if the lien fell within the

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Penrod, 50 F.3d at 454.

42. *See, e.g.*, Bruin Portfolio, LLC v. Leicht (*In re* Leicht), 222 B.R. 670, 682-83 (B.A.P. 1st Cir. 1998) ("Like others, we take Security Indus. Bank's teaching as a strong signal, though short of an express holding, that prospective application of § 522(f)'s lien avoidance provisions does not offend the Fifth Amendment.").

43. In *Penrod*, Judge Posner referred to the axiom that "liens pass through bankruptcy unaffected" as essentially an empty incantation. 50 F.3d at 463 (observing that they do "unless they are brought into the bankruptcy proceeding and dealt with there"). However, in *Dewsnup v. Timm*, 502 U.S. 410, 418 (1992), the Court refused to recognize the right of a chapter 7 debtor to strip an undersecured lien to the value of the collateral under section 506(d), 11 U.S.C. § 506(d) (1994), in part on the basis that to do so would violate the rule concerning the inviolability of consensual liens in bankruptcy. Illustrative of how the Supreme Court has oscillated on this issue, *Dewsnup* stands in sharp contrast to the Court's earlier holding in *United Savings Ass'n v. Timbers of Inwood Forest Associates, Inc.*, 484 U.S. 365 (1988), which rejected the argument that undersecured creditors are entitled to compensation for their lost opportunity costs associated with the delay in realizing on the value of their collateral due to the interposition of a chapter 11 filing. However, in a later decision, *Associates Commercial Corp. v. Rash*, 117 S. Ct. 1879 (1997), which can easily be seen as a limitation on, if not partial overruling of *Timbers*, the Court held that the proper valuation for collateral to be retained by a debtor under a chapter 13 plan is its replacement rather than "forced sale" value. Thus, the Supreme Court has yet to adopt a consistent view on the proper characterization of secured claims in bankruptcy.

44. 11 U.S.C. 522(c)(2) (1994).

45. Even in the absence of this provision, the same result would probably occur since most well-drafted security agreements and mortgages contain a contractual subordination of the borrower's exemption rights in the collateral and the Code's prohibition against waivers of exemption rights extends only to such waivers executed in favor of an unsecured creditor. *See* 11 U.S.C. § 522(e) (1994). The interdictions in section 522(e) also apply to any waiver of the debtor's rights under section 522(f).

46. *See supra* note 30.

parameters of section 522(f), that provision was frequently of no benefit to debtors in jurisdictions in which state law either excluded encumbered property from the definition of exempt property[47] or conditioned the right to claim the property as exempt on the initiation of execution proceedings against the property.[48]

For example, in *Hale County State Bank v. Allen (In re Allen)*,[49] the Fifth Circuit refused to permit a debtor to use section 522(f) to avoid a nonpossessory, nonpurchase-money security interest against certain farming implements and tools of the trade on the basis that the Texas statute conferring the exemption for such items of personalty excluded property subject to a properly affixed lien from the definition of the exemption.[50] The court in *Allen* reasoned that if the debtor could use section 522 to avoid the lien, the effect would be to create an exemption that did not exist under state law in violation of the opt-out provision in Code section 522(b).[51]

Correspondingly, in *Ford Motor Credit Corp. v. Dixon (In re Dixon)*,[52] the Sixth Circuit overturned the lower courts' avoidance of a judicial lien that encumbered the debtors' residence on the

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47. *See, e.g.*, ITT Fin. Servs. v. Fox (*In re* Fox), 902 F.2d 411, 414 (5th Cir. 1990) (holding that because Mississippi law defined exempt property to exclude property subject to the claims of creditors holding a valid security interest, the debtor could not invoke the avoiding power in section 522(f)).

48. *See infra* text accompanying notes 52-62. A similar line of cases refused to permit avoidance under section 522(f)(1) where applicable state law provided that judicial liens attach only to the debtor's equity in the property *in excess* of the exemption amount on the ground that, in these circumstances, the lien could not, by definition, impair the debtor's exemption. *See, e.g., In re* Giordano, 177 B.R. 451 (Bankr. E.D.N.Y. 1995) (following *In re* D'Amelio, 142 B.R. 8 (Bankr. D. Mass. 1992); *In re* Cerniglia, 137 B.R. 722 (Bankr. S.D. Ill. 1992); *In re* Fry, 83 B.R. 778 (Bankr. D. Colo. 1988)).

49. 725 F.2d 290 (5th Cir. 1984).

50. *See id.* at 293. The operative provision of Texas law is now contained in TEX. PROP. CODE ANN. §§ 42.001-.002 (West 1984 & Supp. 1998), which confers a $30,000 exemption for a single adult ($60,000 for a family) in personal property falling within certain designated categories. Those categories include home furnishings, farm implements, and "tools, equipment, books and apparatus including boats and motor vehicles used in a trade or profession." *Id.* § 42.002(a)(4).

51. *See Allen*, 725 F.2d at 292-93 (discussing section 522(b), 11 U.S.C. § 522(b) (1978), and contending that section 522(f) should not be construed to create any *new* exemptions); *see also* Credithrift of Am., Inc. v. Pine (*In re* Pine), 717 F.2d 281 (6th Cir. 1983) (reaching the same conclusion under the Georgia and Tennessee exemptions schema).

52. 885 F.2d 327 (6th Cir. 1989).

ground that, pursuant to Ohio law,[53] the homestead exemption only arises in the context of a forced sale of the property.[54] Because no such sale was pending at the time the debtors in *Dixon* filed their bankruptcy petition, the court observed that the lien at issue could not possibly be construed as impairing an exemption to which the debtors were entitled. In sum, the court concluded that "an Ohio debtor may avoid liens only on that property which the state has declared subject to exemption."[55]

An analogous situation existed in Florida and Louisiana. Under Florida law, the homestead exemption guaranteed by the state constitution,[56] has been deemed inapplicable to liens that attach prior to the time the property acquires its homestead status.[57] Thus, the property is actually *not* exempt to the extent of the debt secured by such a preexisting lien. For this reason, a few bankruptcy courts applying the Florida exemptions during this period held that such liens could not impair the exemption within the meaning of section 522(f).[58] In Louisiana, tools of the trade and other items of personalty, including household goods and furnishings, are exempt without dollar limitation;[59] but again the exemption is inapplicable to debts for which the debtor has voluntarily granted a lien on the property.[60] Thus, in *AVCO*

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53. At the time *Dixon* was decided, applicable Ohio law, OHIO REV. CODE ANN. § 2329.66(A)(1) (Anderson 1989), provided that a debtor domiciled in the state "may hold property exempt from execution, garnishment, attachment, or sale to satisfy a judgment or order, as follows: (1) The person's interest, not to exceed five thousand dollars, in one parcel or item of real or personal property that the person . . . uses as a residence." *Dixon*, 885 F.2d at 329 (emphasis omitted). The current version, OHIO REV. CODE. ANN. § 2329.66(A)(1)(b) (Anderson Supp. 1997), is substantially similar.

54. *See Dixon*, 885 F.2d at 329. For an alternative construction of the statute and a stinging criticism of *Dixon*, see *In re Lynch*, 187 B.R. 536 (Bankr. E.D. Ky. 1995).

55. 885 F.2d at 329 (citing Bessent v. United States, 831 F.2d 82 (5th Cir. 1987)).

56. *See* FLA. CONST. art. X, § 4(a).

57. *See* Bessemer v. Gersten, 381 So. 2d 1344 (Fla. 1980).

58. *See, e.g.*, Deel Rent-A-Car, Inc. v. Levine, 16 B.R. 873, 875 (S.D. Fla. 1982) (affirming the bankruptcy court's determination that the homestead exemption was not effective against a judgment lien that had attached before the property acquired homestead status), *aff'd on other grounds*, 721 F.2d 750 (11th Cir. 1983); *In re* Valdes, 81 B.R. 141 (Bankr. S.D. Fla. 1987). *But see* Linzer v. Hershey *(In re* Hershey), 50 B.R. 329, 331 (S.D. Fla. 1985) (holding that a creditor's judicial lien might be avoided under section 522(f)(1), even though the lien had priority under Florida law, based on the Supremacy Clause of the Constitution).

59. *See* LA. REV. STAT. ANN. § 13:3881(A)(2), (4) (West 1991 & Supp. 1998)

60. *See id.* § 13:3885 (West 1991).

Financial Services, Inc. v. McManus (In re McManus),[61] the Fifth Circuit ruled that the creditor's nonpossessory, nonpurchase-money chattel mortgage on the debtors' household goods and furnishings could not be avoided under section 522(f) because Louisiana had exercised its authority to deny exempt status for mortgaged property.[62]

These limitations on the debtor's ability to effectively use section 522(f) to avoid exemption impairing liens could be circumvented in a non-opt-out state, such as Texas, by electing section 522(d)[63] exemptions;[64] but that course of action, even when an option,[65] might mean accepting far less generous exemption amounts.[66]

The restrictive interpretation of when a lien would be deemed to impair an exemption within the meaning of section 522(f), exemplified by the Fifth Circuit opinion in *McManus*, was not

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61. 681 F.2d 353 (5th Cir. 1982).

62. *See id.* at 357 ("Consequently the chattel mortgages the debtors in the cases *sub judice* wish to avoid do not impair an exemption to which they would have been entitled under section 522(b). To the contrary, the chattel mortgages are the characteristic determinative of whether household goods and furnishings are exempt in Louisiana."). The debtors argued unsuccessfully that the granting of a mortgage on their property did not alter the exempt character of the property, but simply constituted a waiver which, under the prefatory language of section 522(f), would not be enforceable. *See id.* at 356 n.6. Presaging the manner in which the Supreme Court would later frame the issue, the debtors also contended that, as a matter of policy, the states should not be permitted to alter the federal avoidance mechanism. *See id.* at 357 n.7. Judge Dyer's dissenting opinion, *id.* at 357, which was later endorsed by the Supreme Court in *Owen v. Owen*, 500 U.S. 305 (1991), *see infra* text accompanying notes 72-86, argued that the state's opt-out authority related only to exemptions, and not to the debtor's lien avoidance power under section 522(f).

63. 11 U.S.C. § 522(d) (1994).

64. In *Hale County State Bank v. Allen (In re Allen)*, 725 F.2d 290 (5th Cir. 1984), the court implied precisely this argument in justifying its conclusion that the lien was not a qualifying lien for section 522(f) purposes under applicable Texas law. *See id.* at 293.

65. As noted, most states have elected to opt-out of the federal exemption scheme including Ohio, Louisiana, and Florida. *See supra* note 26.

66. Until 1994, when it was raised to $1,500, the federal tools of the trade exemption was limited to $750. *See* 11 U.S.C. § 522(d)(6) (1994). Effective April 1, 1998, under the authority of Code section 104(b), 11 U.S.C. § 104(b) (1994), the tools of the trade exemption was raised to $1625. *See* Revision of Certain Dollar Amounts in the Bankruptcy Code Under Section 104(b) of the Code, 63 Fed. Reg. 7179 (1998) (to be codified at 11 U.S.C.). Although it is true that a debtor electing the federal exemptions might be able to apply some portion of the "wild card" exemption in section 522(d)(5) to the tools of the trade exemption, *see In re* Rivet, 125 B.R. 704, 706 (Bankr. D.R.I. 1991), that option still pales in comparison to the $30,000 exemption potentially available to debtors at the time *Allen* was decided.

universally accepted.[67] Indeed, several federal courts of appeals expressed the view that the plain language of section 522(f) mandated that if the debtor's property would come within the state's list of exemptions but for the presence of the challenged lien, then section 522(f) could be used to avoid the lien.[68] In essence, these courts, including a panel of the Eleventh Circuit,[69] reasoned that deferral to state exemptions under section 522(b)[70] was not intended to extend to lien avoidance under section 522(f). Specifically, these courts recognized that state law characterizations of lien-encumbered property as nonexempt would render section 522(f) useless as a lien avoiding provision, thus contravening the well-established maxim of statutory construction requiring all parts of an act to be given effect whenever possible.[71]

C. *The Supreme Court Speaks*

In 1991, the Supreme Court rendered a decision in *Owen v. Owen*[72] intended to resolve the split in the circuits over the proper interpretation of the triggering language in section 522(f): "to the extent the lien impairs an exemption to which the debtor would have been entitled."[73]

Owen involved an application of the previously mentioned rule that the Florida homestead exemption is subject to exception

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67. *See* John T. Cross, *The Application of Section 522(f) of the Bankruptcy Code in Cases Involving Multiple Liens*, 6 BANKR. DEV. J. 309, 317 (1989) (describing the cases as split, but opining that the view which precludes avoidance when the state law defines encumbered property as nonexempt is inconsistent with the purpose of section 522(f)); *see also* Brown v. Cooley (*In re* Cooley), 72 B.R. 54 (Bankr. N.D. Ala. 1987) (allowing the debtor to avoid a judicial lien arising out of a tort judgment even though applicable state law excluded such claims from the scope of the exemptions).

68. *See, e.g.*, Green v. Snow (*In re* Snow), 899 F.2d 337, 339-40 (4th Cir. 1990) (permitting a debtor to avoid a judicial lien for rent even though, under applicable state law, the exemption did not extend to any execution order or other process issued for rent). The Second, Eighth, and Tenth Circuits also followed this view. *See* Owen v. Owen, 500 U.S. 305, 310 n.2. (1991).

69. *See* Finance One, Inc. v. Hall (*In re* Hall), 752 F.2d 582 (11th Cir. 1985).

70. 11 U.S.C. § 522(b) (1994).

71. *See Snow*, 899 F.2d at 340 (citing congressional intent to protect the debtor's fresh start); *see also Hall*, 752 F.2d at 586 ("To permit states to inhibit the operation of the lien-avoidance provision simply by defining all lien-encumbered property as 'not exempt' would render the statute useless, a result inconsistent with the well-established principle of statutory construction requiring that all parts of an act be given effect, if at all possible." (citations omitted)).

72. 500 U.S. 305 (1991).

73. 11 U.S.C. § 522(f) (1994).

for judgment liens attached prior to the property attaining homestead status.[74] The debtor in *Owen* was subject to a judgment in favor of his former spouse for $160,000, which had been recorded in Sarasota County, Florida. Under Florida law, the judgment would attach to any real property thereafter acquired by the debtor in the county. Later, the debtor purchased a condominium in Sarasota County, but was not able to claim the property as a homestead because he was not the "head of a family" as required by Florida law at the time. The judgment attached to the property at the time of the debtor's acquisition. Subsequently, Florida amended its homestead provision so that the exemption extended to any "natural person."[75] However, as noted, preexisting liens were considered an exception to the exemption.[76]

The bankruptcy and district courts denied the debtor's motion to avoid his ex-spouse's preexisting judgment lien against his exempt homestead because, under state law, the exempt property was subject to the exception for preexisting liens and, therefore, the lien did not fall within the ambit of section 522(f)(1).[77] The Eleventh Circuit affirmed, concluding that "Congress did not intend through section 522(f) . . . to provide a federal exemption greater than that protected by state law."[78] In reaching this conclusion, the *Owen* court appeared to part with circuit precedent,[79] although nowhere in its opinion did the court of appeals confront its 1985 statement that Congress did not intend for "debtors' lien-avoidance powers [to be] eviscerated by state-defined exemptions."[80]

On review, the Supreme Court disagreed with the proposition that the states' ability to exclude lien-encumbered property from

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74. *See supra* notes 56-58 and accompanying text.

75. FLA. CONST., art. X, § 4(a).

76. *See supra* note 57.

77. *See* Owen v. Owen (*In re* Owen), 86 B.R. 691 (M.D. Fla. 1988), *aff'd*, 877 F.2d 44 (11th Cir. 1989), *rev'd*, Owen v. Owen, 500 U.S. 305 (1991) (construing section 522, 11 U.S.C. § 522(f)(1) (1978)).

78. 877 F.2d at 47 (finding that since the lien attached *before* the property qualified as exempt there could be no impairment because the exemption specifically excluded lien-encumbered property).

79. *See* Finance One, Inc. v. Hall (*In re* Hall), 752 F.2d 582, 586 (11th Cir. 1985) (holding that while the states are free to define lien-encumbered property as nonexempt, any such definition would be subject to the provisions of section 522(f)); Southern Discount Co. v. Maddox (*In re* Maddox), 713 F.2d 1526, 1530 (11th Cir. 1983) (questioning the reasoning of the Fifth Circuit in *AVCO Financial Services v. McManus* (*In re McManus*), 681 F.2d 353 (11th Cir. 1982)).

80. *Hall*, 752 F.2d at 587.

an exemption could be used to limit the debtor's federally granted right to avoid exemption impairing liens.[81] According to the majority opinion,[82] which was authored by Justice Scalia, the conceptual mistake made by the lower courts was to frame the penultimate question in terms of whether the lien impairs an exemption to which the debtor is *in fact* entitled, instead of, as called for by the language of section 522(f), "an exemption to which [the debtor] *would have been* entitled but for the lien itself."[83] However, because the lien at issue in *Owen* might have attached to the property *simultaneously* with the acquisition of the debtor's interest in the property, in which case the "fixing of a lien on an interest of the debtor in property" requirement of the statute might not have been satisfied,[84] the Court remanded the case for further proceedings.[85] In addition, the Court in *Owen* did

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81. *See Owen*, 500 U.S. at 313-14 ("Florida's exclusion of certain liens from the scope of its homestead protection does not achieve a similar exclusion from the Bankruptcy Code's lien avoidance provision." (footnote omitted)).

82. In a separate dissent, Justice Stevens urged that because as of the date of the fixing of the lien the property was not exempt, there was no basis for avoidance of the respondent's lien. *See id.* at 317-18 (Stevens, J., dissenting). On the other hand, using the same reasoning, he also concluded that *McManus* was wrongly decided since, at the time the creditor's lien attached, the debtors were already entitled to an exemption under Louisiana law. *See id.* at 320. In sum, Justice Stevens's point of contention with the majority was whether the time for determining if the challenged lien impaired an exemption to which the debtor would have been entitled was on the date the lien attached or the date the petition was filed. *See id.* at 314 n.6.

83. *Id.* at 310-11.

84. In *Farrey v. Sanderfoot*, 500 U.S. 291 (1991) (decided contemporaneously with *Owen*), the Court held that the "fixing of the lien" language in section 522(f), distinct from the "would have been entitled" provision at issue in *Owen*, requires that the debtor have an interest in the property *prior* to the time the lien attached. *See also* Marine Midland Bank v. Scarpino (*In re* Scarpino), 113 F.3d 338 (2d Cir. 1997) (holding that a debtor could not avoid a judgment lien to protect the debtor's homestead since, under New York law, the recorded lien attached to after-acquired property simultaneously with the debtor's acquisition of that property); *In re* Farrar, 219 B.R. 48, 53 (Bankr. D. Vt. 1998) (relying on *Farrey* in ruling that the redistribution of marital property as part of a divorce decree meant that debtor's interest in the property, even though preexisting, attached at the same time as his ex-spouse's judicial lien). In *Farrey*, which involved a divorce lien, the Court concluded that avoidance was improper since the ownership interest of the debtor and the collateral interest of the debtor's ex-spouse had arisen simultaneously. The holding in *Farrey* was awkward, and sections 522(f)(1)(A)(i)-(ii), added by the 1994 Amendments, was an attempt to clarify the law relating to judicial liens arising out of divorce proceedings. *See supra* note 18.

85. *See Owen*, 500 U.S. at 314. The Court also noted that the court of appeals had not passed on the question of whether the Florida statute extending the homestead exemption might be challenged as a taking. *See id.* On remand, the

not address how, if the lien was deemed to impair the exemption, the extent of impairment was to be determined. In leaving unresolved the question of whether the "debtor's interest" referred narrowly to the debtor's equity in the property or more broadly to the debtor's rights of ownership,[86] the Court paved the way for the next round of interpretive chaos over section 522(f).

Eleventh Circuit relied on *Farrey* in denying the debtor relief yet again, pointing out that the ex-spouse's lien actually attached *prior* to the property becoming a homestead. Thus, the court concluded that the fixing of the lien did not impair an exemption to which the debtor would otherwise have been entitled because, insofar as that lien was concerned, the property was not exempt. *See* Owen v. Owen (*In re* Owen), 961 F.2d 170 (11th Cir. 1992). Ironically, this is the same reasoning that led Justice Stevens to dissent in *Owen*. *See supra* note 82. *But see In re* Wilbur, 217 B.R. 314 (Bankr. M.D. Fla. 1998) (concluding that under the Supreme Court's ruling in *Owen*, the fact that the debtor's property did not, under state law, acquire exempt status until *after* the judgment lien in question had attached did not preclude the debtor from utilizing section 522(f) to avoid the lien on his Florida homestead).

86. *Cf.* Howard, *supra* note 12, at 155 n.18 (observing that courts and commentators do not tend to be consistent in how they use the term "equity"). The narrow view of the extent of a debtor's interest in property for section 522(f) purposes was adopted by numerous courts after *Owen* and prior to the 1994 Amendments. *See* David Gray Carlson, *Security Interests on Exempt Property After the 1994 Amendments to the Bankruptcy Code*, 4 AM. BANKR. INST. L. REV. 57, 69 n.100 (1996). Indeed, the Eleventh Circuit decreed that this approach was required under the Supreme Court's reasoning in *Dewsnup v. Timm*, 502 U.S. 410 (1992). *See* American Cast Iron Pipe Co. v. Wrenn (*In re* Wrenn), 40 F.3d 1162, 1165-66 (11th Cir. 1994). Of course, if the "underwater" portion of the qualifying lien was left intact not only would the debtor be deprived of future appreciation, but the exemption value created would be meaningless unless the court was also prepared to preserve the avoided portion of the lien for the debtor. *See* Ponoroff & Knippenberg, *supra* note 37, at 2240-41 n.20 (indicating that not all courts were prepared to do so); *see also* Cross, *supra* note 667, at 333-35 (arguing that the fresh start objectives of section 522 are thwarted by an approach that permits junior lienors rather than the debtor to benefit from avoidance of an exemption impairing lien).

Under the latter construction, where there is insufficient equity to satisfy both the exemption amount and the lien, the entire lien would be subject to avoidance, thereby preserving the value of any postdischarge appreciation for the debtor. *See, e.g.*, *In re* Magosin, 75 B.R. 545, 550 (Bankr. E.D. Pa. 1987) (concluding that the debtor has "an interest in property" even when the creditor's lien exceeds the value of the security). In *Owen*, the Supreme Court, in dicta, seemed to imply its concurrence with the latter approach by citing *In re Brantz*, 106 B.R. 62, 68 (Bankr. E.D. Pa. 1989), and *In re Carney*, 47 B.R. 296, 299 (Bankr. D. Mass. 1985), as providing the "more precise formulation" of the process for determining the extent to which a judicial lien impaired the exemption. *See Owen*, 500 U.S. at 312-13 & n.5. Presumably, it would make no difference whether the action involved a judicial lien or a qualifying nonpossessory, nonpurchase money lien since, at the time *Owen* was decided, the statute did not distinguish the procedures between the two kinds of lien subject to avoidance under section 522(f). *See* Tower Loan, Inc. v. Maddox (*In re* Maddox), 15 F.3d 1347, 1351 (5th Cir. 1994).

*D. The Post-*Owen *Era*

Although *Owen* appeared to make clear that the availability of lien avoidance under section 522(f) was controlled by federal not state law, neither the Supreme Court's decision nor the Bankruptcy Code specified the nature of the debtor's interest in property that was to be immune from impairment or how impairment was to be defined. Moreover, surprisingly, in at least one circuit, *Owen* failed to settle completely the question of whether the states could define their exemptions in a manner that excluded encumbered property from the exemption.

1. State Definition of Lien-Encumbered Exemptions Redux

Virtually all of the courts that had previously ruled that the lien avoidance provisions of section 522(f) could be limited by state exceptions conceded that their earlier decisions were overruled by *Owen*.[87] The Sixth Circuit, however, steadfastly refused to believe that the Supreme Court actually meant what it said in *Owen*. Specifically, in *Resolution Trust Corp. v. Moreland (In re Moreland)*,[88] the Sixth Circuit observed that although *Owen* reflected a policy against permitting the states to circumvent the federal lien avoidance provisions, it did "not hold that the states may impose no limits on lien avoidance in the context of impaired exemptions."[89]

The court in *Moreland* proceeded to distinguish the Florida law at issue in *Owen* from Ohio's homestead exemption law, observing that operation of the Florida law would have *permanently* deprived the debtor of his homestead exemption.[90] By contrast, the Ohio statute only *deferred* the time when, and changed the circumstances under which, the exemption could be

87. *See, e.g.*, Davis v. Davis (*In re* Davis),131 F.3d 1120 (5th Cir. 1997) (noting that, under *Owen*, the Code uses state law soley to identify and quantify property that the debtor may exempt in a bankruptcy administration); Belknap v. Henderson (*In re* Henderson), 18 F.3d 1305 (5th Cir. 1994); Tower Loan, Inc. v. Maddox (*In re* Maddox), 15 F.3d 1347, 1351 (5th Cir. 1994); Holmes v. Hastings (*In re* Hastings), 185 B.R. 811 (B.A.P. 9th Cir. 1995); *In re* Erwin 199 B.R. 628, 629 (Bankr. S.D. Tex. 1996) (conceding that federal law determines the availability of lien avoidance).

88. 21 F.3d 102 (6th Cir. 1994), *cert. denied*, 513 U.S. 956 (1994).

89. *Id.* at 106.

90. *See id.*

claimed.[91] In light of this distinction, the court reasoned, without clear explanation, that its earlier holding in *Ford Motor Credit Corp. v. Dixon (In re Dixon)*[92] was still good authority.[93] Thus, because no judicial sale was pending at the time of the bankruptcy filing in *Moreland*, the Sixth Circuit held that there was no exemption to be impaired by the creditor's judicial lien. Consequently, the court reversed the orders of the bankruptcy and district courts granting the debtor's motion to avoid the defendant's judicial lien against her residence.[94]

2. Inquiring into Impairment

In ascertaining the extent to which a lien "impairs" an exemption, the courts developed a dizzying array of approaches in circumstances where: (1) the debtor had no equity in the property; (2) equity existed but was less than the full amount of the exemption; or (3) the property was subject to multiple liens, one or more of which were unavoidable.[95] As set forth below, several circuit courts of appeals agreed that the extent of impairment was limited by the lesser of the amount of the debtor's equity in the property or the exemption itself. Other, mostly lower courts, gauged impairment with reference to postavoidance consequences. Under the former approach, if the debtor's interest was narrowly construed as referring only to the debtor's "equity," however that term might be defined, the portion of the qualifying lien in excess of the lesser of the debtor's equity or the exemption amount would be deemed not to impair and could not be avoided.[96]

While no firm consensus emerged, by 1994 at least four circuit courts of appeals had ruled that, under the plain language of section 522(f), the debtor's lien avoidance rights were limited

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91. *See supra* note 53. *But see In re* Lynch, 187 B.R. 536, 549 (Bankr. E.D. Ky. 1995) (explaining why the Ohio statute does not merely *postpone* the debtor's right to an exemption).

92. 885 F.2d 327 (6th Cir. 1989).

93. *See Moreland*, 21 F.3d at 106-07.

94. *See Moreland*, 142 B.R. 221 (Bankr. S.D. Ohio 1992), *rev'd*, 21 F.3d 102 (6th Cir. 1994), *cert. denied*, 513 U.S. 956 (1994).

95. *See* Howard, *supra* note 14, at 160-75 (analyzing the problems created under section 522(f) when the exempt property was subject to junior or senior nonavoidable liens, and the effect of those liens on the calculation of the debtor's equity for courts that limited avoidance on that basis).

96. *See supra* note 86.

to the extent that the qualifying lien interfered with available exemptions as measured by the dollar amount of the exemption claim itself.[97] Furthermore, in situations where the debtor's equity in the property over and above senior unavoidable liens was *less than* the dollar value of the exemption, several courts held that there was no exemptible interest beyond such equity to be impaired by the lien regardless of the exemption amount allowed by the statute.[98] Other cases took this proposition even a step further and included in the calculation of the debtor's equity (or lack thereof) *all* unavoidable consensual liens, including those junior to the lien being challenged.[99] Under this variation, the debtor's ability to avoid qualifying liens was limited to the lesser of the dollar amount of the exemption or the debtor's equity in the property net of all unavoidable liens.[100]

Despite the subtle but important shadings in difference from case to case, all of these courts agreed that under no circumstances could impairment exceed the amount of the exemption. For example, in *American Cast Iron Pipe Co. v. Wrenn (In re Wrenn)*,[101] the debtors sought to avoid *in toto* a $20,000 judicial lien against their residence which, under Alabama law, was entitled to a $5,000 homestead exemption.[102] The debtors argued that unless the entire lien was avoided, any postdischarge appreciation in the property would inure to the benefit of the judgment lienor rather than to them, thereby undermining their fresh start.[103] Noting, however, that the power to avoid liens under section 522(f) is limited *to the extent* that the qualifying lien impairs an exemption, the Eleventh Circuit ruled that the lien could only be avoided to the extent of the debtors' $5,000 home-

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97. *See supra* note 14.

98. *See, e.g.*, First Nat'l Bank v. Menell (*In re* Menell), 37 F.3d 113, 115 (3d Cir. 1994) (finding that "only that part of the lien which interferes with the exemption may be avoided").

99. *See generally* Ponoroff & Knippenberg, *supra* note 37, at 2243 n.28.

100. *See id.* To be sure, there was great variation from case to case. For instance, in *West v. West* (*In re West*), 68 B.R. 647 (Bankr. C.D. Cal. 1986), the court concluded that impairment extended to the dollar amount of the exemption even if the debtor's present equity in the property was presently something less than that amount. *See also* David Dorsey Distrib. v. Sanders (*In re* Sanders), 39 F.3d 258, 262 (10th Cir. 1994) (holding that where the lien exceeds the exemption amount, the debtor may avoid only the amount of the exemption).

101. 40 F.3d 1162 (11th Cir. 1994).

102. *See id.* at 1163-64.

103. *See id.* at 1165 n.4 (debtors also unsuccessfully argued that the creditors lien was void under section 506(d), 11 U.S.C. § 506(d) (1994)).

stead.[104] In effect, the court carved the exemption out of the lien, but in so doing left the balance of the lien intact as a continuing encumbrance against the property. As a practical matter, assuming that a significant portion of the lien was underwater,[105] this approach rendered exercise of the debtor's power under section 522(f) to avoid exemption impairing liens an essentially futile gesture.[106]

The contrary view, followed by a large number of lower courts, was to gauge impairment with reference to postavoidance consequences rather than in terms of the dollar amount of the exemption. These courts took the broad view of "impairment," analyzing it with reference to the overriding fresh start policy that accounted for section 522(f) in the first place.[107] Therefore, they refused to equate the term "interest" within the meaning of section 522(f), with the generic term "equity."[108] The bankruptcy court in *In re Vizentinis,*[109] defended this lien-stripping approach as necessary to maintain "the debtor's full exemption by insuring that the judicial lien which survives can in no way adversely affect the homestead exemption."[110] In *Vizentinis,* decided after the effective date of the 1994 Amendments but governed by prior

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104. *See id.* at 1166-67 (relying heavily on City Nat'l Bank v. Chabot (*In re* Chabot), 992 F.2d 891 (9th Cir. 1993)).

105. A lien is underwater to the extent that there is no value, over and above the sum of senior nonavoidable liens and the debtor's exemption. *See generally* Howard, *supra* note 14, at 165. For example, in *Wrenn,* if the debtor's home had been worth $60,000, and subject to a $65,000 unavoidable senior mortgage, any judicial liens would be underwater and, therefore, immune from avoidance under section 522(f)(2).

106. If a significant portion of the lien remains as an encumbrance against the property, not only does the debtor lose the value of future appreciation, but, in all likelihood, the property itself because, unless the debtor is prepared to reaffirm the debt, foreclosure is inevitable as soon as the stay is lifted. *See supra* note 14. To make matters worse, if, as some courts held, *see supra* note 86, the avoided portion of the lien was not preserved for the benefit of the debtor, the debtor could expect to receive nothing from the proceeds of sale or foreclosure. *See,* Howard, *supra* note 14, at 166-67.

107. *See generally* Cross, *supra* note 67, at 313-15 (discussing the circumstances leading Congress to include judicial, as well as nonpossessory, nonpurchase-money liens within the scope of section 522(f) as originally drafted).

108. *See* Ponoroff & Knippenberg, *supra* note 37, at 2243-44 n.29; *see also* W.H. Squire Co. v. Chesanow (*In re* Chesanow), 25 B.R. 228, 230 (Bankr. D. Conn. 1982) (pointing out that the word "interest" as used in section 522(f) is not the substantial equivalent of "equity" and that, even without any equity, a debtor may have a valid interest, such as the right of possession and the right to redeem).

109. 175 B.R. 824 (Bankr. E.D.N.Y. 1994).

110. *Id.* at 827.

law, the debtor was entitled to a $10,000 homestead exemption but had only $3,000 of equity in the property over and above the sum of senior nonavoidable liens. The lienholder argued that its lien could only impair to the extent of the debtor's equity, in this case, $3,000. The court disagreed, noting that a judicial lien survives only to the extent that a debtor's equity results in a surplus after deducting the homestead exemption.[111] The effect of this ruling was to ensure that any postpetition appreciation in the value of the property or other equity build-up would accrue to the benefit of the debtor rather than the judicial lien holder.

The difference between the two approaches was manifest in circumstances where the debtor either had no equity in the property or the debtor's equity was less than the amount of the exemption. For example, consider a situation involving a judicial lien affixed to the debtor's homestead. Assume the property has a value of $100,000, is subject to a nonavoidable first mortgage of $80,000 and a judicial lien in the amount of $50,000, and is eligible for a homestead exemption of $25,000. Under the *Wrenn* approach, the exemption limitation defines the maximum extent of impairment. Accordingly, the judicial lien would be scaled back by a maximum of $25,000[112] and the property would emerge from the bankruptcy case in essentially the same condition that it went in—namely, overencumbered by the combination of the $80,000 mortgage and the remaining $25,000 of the judicial lien. This means that the unavoided portion of the lien would attach to any appreciation or equity build-up in the property occurring after bankruptcy.[113] By contrast, under the approach endorsed in

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111. *See id.* (citing *In re* Serapiglia, 123 B.R. 481, 488 (Bankr. E.D.N.Y. 1990)).

112. This assumes the more "liberal" view that the full exemption may be carved out of the lien. *See supra* note 86. Among the courts that capped avoidance at the lesser of the exemption amount or the debtor's equity in the property, the lien would be set aside only to the extent of $20,000.

113. This assumes that the debtor has reaffirmed the debt; otherwise, as earlier observed, in all likelihood the property would be lost to foreclosure as soon the case was closed or the discharge granted. *See supra* note 14. In the case of wholly underwater liens, a few courts attempting to deal with the issue of entitlement to postpetition appreciation took the position that the qualifying lien should not be eliminated, but rather only subordinated to the extent of the debtor's exemptible interest in the property. This would ensure that the creditor's interest would attach if the property appreciated to the point where the debtor's equity exceeded the maximum allowable exemption. *See, e.g.*, *In re* D'Amelio, 142 B.R. 8 (Bankr. D. Mass. 1992). However, permitting the lien to "linger" in the hopes of enjoying the benefit of future value runs contrary to the language of the statute, which clearly speaks in terms of "avoidance," and frustrates the fresh start objectives of

Vizentinis, the qualifying lien could be set aside in its entirety since there was no value to which the lien might attach over and above the sum of all nonavoidable liens plus the exemption. In other words, because the sum of the first mortgage ($80,000) and the homestead exemption ($25,000) exceeds the value of the property, permitting any portion of the judicial lien to survive would necessarily impair the debtor's exemption.[114]

The issue concerning the extent of impairment became even less clear when a second nonavoidable was introduced into the hypothetical scenario. Consider, for example, that the property is also subject to a second mortgage, in the amount of say $20,000, subordinate under state law to the judicial lien. In ascertaining impairment, some courts would simply ignore the junior unavoidable lien, yielding essentially the same result as above.[115] However, other courts, those requiring *real* equity before permitting any avoidance, would conclude that because the sum of the nonavoidable liens, without regard to their priority in relation to the judicial lien, exceeds the value of the property, the debtor has no "interest" in the property to be impaired.[116]

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section 522(f), which are to permit debtors the full benefit of their exemptions. *See* Howard, *supra* note 14, at 171-75.

114. Earlier, the bankruptcy court in *In re Brantz*, 106 B.R. 62, 68 (Bankr. E.D. Pa. 1989), expressed this approach by employing the following formula: (1) determine the fair market value of the property; (2) deduct the amount of all liens to be avoided; (3) deduct further the amount of the exemption to which the debtor is entitled with respect to the property; (4) if (3) is a negative figure, avoid all qualifying liens; (5) if (3) does not yield a negative figure, do not permit avoidance of qualifying lien, in order of priority, to the extent of the positive value. In substance, this approach was later adopted in the 1994 Amendments. *See infra* note 133.

115. *See, e.g.*, *In re* Harris, 120 B.R. 142, 148 (Bankr. S.D. Cal. 1990) (holding that the debtor's equity in the property is determined by subtracting only senior security interests from the value of the property).

116. *See, e.g.*, Overhead Door Co. v. Hazard (*In re* Hazard), 113 B.R. 494, 498-99 (Bankr. W.D. Wis. 1990) (permitting avoidance of a senior judicial lien where the debtor's equity was eroded by junior unavoidable lien). As a practical matter, however, on different facts this view gave the debtor the power to make a nonimpairing judicial lien avoidable by executing a nonavoidable junior mortgage. *See, e.g.*, *In re* Green, 64 B.R. 462 (Bankr. S.D. Ind. 1986). For instance, in the hypothetical given, if the first mortgage were only $20,000, the judicial lien would not impair the $25,000 exemption. However, if the debtor then executed a second consensual mortgage securing an additional $20,000 indebtedness, the judicial lien would impair only to the extent of $15,000. *But see In re* Baldwin, 84 B.R. 394, 399 (Bankr. W.D. Pa. 1988) (holding that when a debtor consents to a subordinate mortgage, he ratifies all prior judicial liens on that property; thus, those liens should be deemed consensual for purposes of section 522(f)).

Finally, even among courts that would avoid all or a portion of the judicial lien, there was further disagreement in the case of multiple liens. These courts disagreed over whether the avoidance simply inured to the benefit of the consensual junior lienor or whether, by analogy to the lien preservation provision in Code section 551,[117] the avoided lien could be preserved for the benefit of the intended beneficiary of the avoiding power, the debtor. This issue formed the basis for disagreement between the majority and dissenting opinions in the Third Circuit's decision *First Bank of Greater Pittson v. Simonson (In re Simonson)*.[118] The majority ruled that although Code section 522(i)(2)[119] appeared to preserve the avoided lien for the debtor's benefit in much the same way that section 551 preserves liens avoided by the trustee for the benefit of the estate, section 522(i)(2) itself conferred no substantive right to avoid liens on exempt property. That right, according to the court, was set out in section 522(f)(1). Accordingly, because the debtor lacked equity in the property, the *Simonson* court ruled that the lien did not impair an exemption.[120] The dissent, on the other hand, took the view that section 522(f)(1) allowed the debtor to "create" equity in exempt property by avoiding certain judicial liens.[121] Therefore, the dissent reasoned that section 522(i)(2) should be construed to permit the interest of the debtor's exemption to "stand in the shoes" of the avoided judicial liens.[122] Although recognizing that this approach might work "to the disadvantage of a judicial lienor who originally had a valid lien on property in which the debtor once had ample equity out of which to satisfy his homestead exemption in the event of bankruptcy," the dissent concluded that the majority's interpretation was not in keeping with Congress's decision to promote the debtor's fresh start.[123]

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117. 11 U.S.C. § 551 (1994). *See supra* note 98.

118. 758 F.2d 103 (3d Cir. 1985).

119. 11 U.S.C. § 522(i)(2) (1994).

120. *See id.* at 105-06.

121. *See id.* at 111-12 (Becker, J., dissenting).

122. *See id.* The legislative history of the 1994 Amendments indicates an intent to adopt Judge Becker's position in *Simonson*, which presumably includes his view as to who should enjoy the benefit of an avoided lien that is sandwiched between two nonavoidable liens. Still, the only statutory provision relating to preservation and priority continues to be the ambiguous language in section 522(i)(2). *See infra* text accompanying notes 144-48.

123. *See* 758 F.2d at 112-13.

II. CONGRESS RESPONDS: THE 1994 AMENDMENTS

As Congress approached the question of bankruptcy reform in 1993 and 1994, there was very little doubt that the lack of uniformity involving the interpretation of section 522(f) was impeding the efficiency and effectiveness of the consumer bankruptcy system.[124] While *Moreland* might have been perceived as an aberration in terms of who retained authority to control the limits of debtors' avoiding powers under section 522(f),[125] it was much more difficult to shrug off the widespread confusion that had developed over when and to what extent a lien would be deemed to impair the debtor's interest in property. Moreover, some creditor industry group spokespersons complained that because the ability to avoid nonpossessory, nonpurchase-money liens under section 522(f) extended to certain small-business and agricultural collateral,[126] as well as to traditional consumer goods, another effect of *Owen* was to chill the availability of credit to those sectors of the economy, particularly in states with either no limit (like Louisiana) or a high dollar limit (like Texas) on Tools of the Trade Collateral.[127] Although this avowal of concern for the well-being of the nation's farmers and small-business debtors (coming from the chief apologists for the credit industry) may have been too self-serving to take at face value, the possibility that *Owen* had endorsed a construction of section 522(f) that exceeded the original intentions of the drafters of the Code[128] was not without some merit.

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124. For a more complete analysis and discussion of the lack of uniformity in the administration of the consumer bankruptcy system, as well as some of the reasons therefore and the positive and negative effects thereof, see Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501 (1993); and Teresa A. Sullivan et al., *The Persistence of Local Legal Culture: Twenty Years of Evidence from the Federal Bankruptcy Courts*, 17 HARV. J.L. & PUB. POL'Y 801 (1994).

125. *See supra* note 88.

126. *See supra* note 33.

127. *See Bankruptcy Reform: Hearing Before the Subcomm. on Economic and Commercial Law of the House Comm. on the Judiciary*, 103d Cong. 219-20 (1995) (statement of Philip S. Corwin, Dir. and Counsel, Operations and Retail Banking, of the Am. Bankers Assoc.) ("Restoring the unencumbered flow of agricultural and small business credit would be greatly aided by the legislative reversal of [*Owen*].").

128. The legislative history to section 522(f) indicates that Congress was concerned with the practice employed by numerous consumer lenders of taking blanket liens in the debtor's household goods which, from an economic standpoint, had little or no value. However, these liens, and the threat of their enforcement,

Regardless of the source of motivation, Congress responded with the 1994 Amendments to the multiple problems that had developed under section 522(f) in a manner that both heartened and confounded neutral observers of the consumer bankruptcy system. New section 522(f)(2) eliminated the uncertainty surrounding the impairment requirement[129] and, likely, overruled the Sixth Circuit's awkward interpretation of *Owen* in *Moreland*.[130] New section 522(f)(3), on the other hand, while temporarily silencing credit industry lobbyists, placed an arbitrary limit on debtors' avoidance powers for specified kinds of collateral and, in the process, planted the seeds for a new round of interpretational chaos in the courts.[131]

A. *Impairment No Longer Impaired by Uncertainty: Section 522(f)(2)*

The 1994 Amendments addressed in a definitive fashion the unsettled exegetic issue remaining after *Owen*: the proper method for determining whether and to what extent a lien would be deemed to impair the debtor's interest in exempt property.[132] In

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gave lenders considerable leverage over the debtor who could then be sued to extract reaffirmations in bankruptcy for debts that were, as a practical matter, unsecured. *See* H.R. REP. NO. 95-595, at 166-73 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6127 [hereinafter 1978 HOUSE REPORT]. It was these same concerns about unsavory industry practices that later gave rise to the Federal Trade Commission's regulations prohibiting most forms of nonpurchase-money security interests. *See supra* note 32. With respect to judicial liens, Congress's motivation was somewhat different. The idea was to discourage judgment creditors, regardless of the source of their underlying claim, from engaging in a race to encumber all of the debtor's exempt assets prior to bankruptcy and, thus, undermine the debtor's chances for a fresh start. Since these creditors were not original "reliance" creditors, Congress saw fit to include them within the ambit of the debtor's exemption impairing avoiding powers. *See* 1978 HOUSE REPORT, *supra*, at 126. Tools of the Trade Collateral, while often closely related to other items of consumer goods, did not neatly fit into either category and, indeed, were more likely than both Consumer and Medical Appliance Collateral to have significant value on which a lender might have legitimately relied in extending the credit in the first place.

129. *See infra* Part II.A.

130. *See supra* notes 88-94 and accompanying text.

131. *See infra* Parts II.B-C, III.

132. *See infra* text accompanying notes 134-41. The differing positions that had developed are summarized in *In re Witkowski*, 176 B.R. 114 (Bankr. D. Mass. 1994): (1) the "Full Avoidance Approach"; (2) the "Partial Avoidance Approach"; and (3) the "Subordination Approach." For an expanded discussion using the same terminology, see Scott Everett, Comment, *Debtors' Delight? Bankruptcy Reform Act of 1994: How Revisions to 11 U.S.C. § 522(f) Affect Debtors' Ability to Avoid Liens Which Impair*

this matter Congress spoke in plain and simple terms, reminding the courts and the credit industry of the original goals of section 522(f) and sending an important message concerning the preferred construction of the much more difficult language in section 522(f)(3). Specifically, section 303 of the 1994 Amendments added a new section 522(f)(2) to the Bankruptcy Code,[133] which contained the following formulaic approach for ascertaining the extent to which a lien would be deemed to impair an exemption:

> (2)(A) For purposes of this subsection, a lien shall be considered to impair an exemption to the extent that the sum of—
> (i) the lien;
> (ii) all other liens on the property; and
> (iii) the amount of the exemption that the debtor could claim if there were no lien on the property;
> exceeds the value that the debtor's interest in the property would have in the absence of any liens.[134]

Although application of the formula itself leaves little doubt about the matter,[135] the legislative history of section 522(f)(2) explicitly states that this provision is intended to codify *In re Brantz*[136] and further rejects the approach taken in *City National*

Texas Personal Property Exemptions, 26 TEX. TECH L. REV. 1331 (1995).

133. *See* 11 U.S.C. § 522 (1994), *amended by* 1994 Amendments § 303. This also resulted in the renumbering of former section 522(f)(2), 11 U.S.C. § 522(f)(2) (1978), to section 522(f)(1)(B), 11 U.S.C. § 522(f)(1)(B) (1994). *See infra* note 134.

134. 11 U.S.C. § 522(f)(2)(A) (1994). The two additional subparagraphs in the new section 522(f)(2), (B) & (C), clarified that in the case of multiple liens, an avoided lien was not to be considered in the calculation under section 522(f)(2)(A) and that section 522(f)(2) does not apply with respect to a judgment arising out of a mortgage foreclosure, respectively. The latter provision is consistent with the notion that section 522(f)(1)(A) applies to only nonconsensual liens. *Cf.* California Cent. Trust Bankcorp v. Been (*In re* Been), 153 F.3d 1034 (9th Cir. 1998) (holding that section 522(f)(2)(C) was inapplicable to the claim of a junior lienholder whose interest in the property had been previously extinguished by foreclosure of the senior lien).

135. The legislative history aptly notes that the amendment "provides a simple [and more predictable] arithmetic test to determine whether a lien impairs an exemption." H.R. REP. NO. 103-835, at 53 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3362 [hereinafter 1994 HOUSE REPORT].

136. 106 B.R. 62 (Bankr. E.D. Pa. 1989); *see* 1994 HOUSE REPORT, *supra* note 135, at 52; *see also* Bank of Am. Nat'l Trust & Sav. Ass'n v. Hanger (*In re* Hanger), 217 B.R. 592, 596 (B.A.P. 9th Cir. 1997) (noting that the formula in section 522(f)(2)(A) is "simply a restatement of the *Brantz* formula"); *cf. In re* Thomsen, 181 B.R. 1013, 1016 n.2 (Bankr. M.D. Ga. 1995) (observing that the formulas used by Congress and the *Brantz* court differ in form but, presumably, not in operation).

Bank v. Chabot (In re Chabot)[137] and *Wrenn*[138] by the Ninth and Eleventh Circuits, respectively.

Applying this formula to the hypothetical scenario set out earlier in Part I involving a residence with a fair market value of $100,000, subject to a nonavoidable first mortgage of $80,000 and a judicial lien securing a $50,000 judgment, and entitled under local law to a $25,000 homestead exemption, it is now beyond cavil that the entire lien impairs and, therefore, can be set aside under section 522(f)(1)(A).[139] Consistent with

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137. 992 F.2d 891 (9th Cir. 1993). The Ninth Circuit has conceded that *Chabot* has been overruled in *Heskett v. Jones (In re Jones)*, 106 F.3d 923, 924 n.2 (9th Cir. 1997).

138. 40 F.3d 1162 (11th Cir. 1994). In *John Hancock Mutual Life Insurance Co. v. Holloway (In re Holloway)*, 81 F.3d 1062, 1069-70 (11th Cir. 1996), the court applied *Wrenn* because the case was filed before the effective date of the 1994 Amendments, but acknowledged that, for cases filed after the effective date, *Wrenn* had been overruled.

139. The calculation of the extent to which the judicial lien would be considered to impair as required by section 522(f)(2)(A) would be as follows: the sum of the qualifying lien ($50,000), all other liens on the property ($80,000), the exemption amount ($25,000), less the fair market value of the property ($100,000) equals $55,000. As a result, the debtor would immediately enjoy an exemption for the $20,000 equity over and above the nonavoidable first lien and, assuming foreclosure of the first mortgage could be avoided, would also enjoy the benefit of any future appreciation in the property. For citation to several cases applying the formula in this fashion, see Ponoroff & Knippenberg, *supra* note 37, at 2244 n.32. *See also* Copelco v. Choice (*In re* Choice), No. 97-15868DAS, 1997 Bankr. LEXIS 1493 (Bankr. E.D. Pa. Sept. 23, 1997) (ruling that debtor's lack of equity in the property is no longer a bar to application of section 522(f)(1)); *In re* VanZant, 210 B.R. 1011 (Bankr. S.D. Ill. 1997) (noting that under the new formula, the qualifying lien will survive only if the debtor's property has sufficient value to satisfy all liens against the property and, at the same time, to give effect to the debtor's exemption in the property).

Obviously, this amendment clarifies most of the confusion and disagreement that had raged in circumstances where the debtor had either no equity in the property over the sum of consensual liens or the amount of such equity was less than the maximum exemption amount. *See supra* notes 95-123 and accompanying text. Under the new formula, the judicial lien will be avoided in its entirety when there is no equity in the property or, as in the hypothetical in the text, the equity above the consensual liens is *less* than the full exemption amount to which the debtor is entitled. However, if the debtor's equity is greater than the maximum exemption amount but less than the sum of the exemption claim *plus* the qualifying lien, the formula suggests some form of partial avoidance. *See, e.g, In re* Thomsen, 181 B.R. 1013 (Bankr. M.D. Ga. 1995). For example, if in the hypothetical, the value of the property were $115,000 under section 522(f)(2)(A), the judicial lien would impair to the extent of $35,000 ($155,000 - $120,000) and, presumably, be reduced by that amount. While this would permit the debtor to receive the full exemption amount assuming, *see infra* notes 143-48 and accompanying text, that the avoided portion of the lien is preserved for the debtor's benefit, it is unclear who should receive the benefit of future appreciation. *See* 181 B.R. at 1013 (noting that, as a practical

the fresh start instincts animating enactment of section 522 to begin with, this result preserves future appreciation for the debtor.

As far as the related question is concerned, where the judicial lien is sandwiched between two unavoidable consensual liens that together equal or exceed the value of the property, application of section 522(f)(2)'s equation unequivocally leads to the conclusion that the impairment extends to the full extent of the judicial lien.[140] Thus, the qualifying lien can be avoided in its entirety, and any notion that it is merely subordinated is no longer tenable.[141]

As for the subsidiary issue, the addition of section 522(f)(2) does not offer specific guidance as to whether the benefit of the avoidance inures to the junior mortgagee, whose lien would simply "spread" to capture the newly created value, or whether it

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matter, it is unrealistic for the debtor and the creditor to somehow share in future appreciation, but that allowing the appreciation to inure to the benefit of the creditor is inconsistent with Congress's apparent intention to include in the definition of impairment interference with enjoyment of future appreciation). Most courts have concluded that some form of partial avoidance is inevitable where equity exists beyond the sum of consensual liens and the exemption. *See, e.g.*, East Cambridge Sav. Bank v. Silveira (*In re* Silveira), 141 F.3d 34 (1st Cir. 1998) (holding that when the unencumbered value of the property exceeds the sum of the targeted lien, all other liens, and the amount of the claimed exemption, the debtor may only avoid the fixing of the judicial lien on his property to the extent that the amount of the lien *exceeds* such excess value); *Hanger*, 217 B.R. at 596; Federal Deposit Ins. Corp. v. Finn (*In re* Finn), 211 B.R. 780, 782-84 (B.A.P. 1st Cir. 1997); *In re* Plott, 220 B.R. 596 (Bankr. N.D. Ohio 1998); Mignini v. Canelos (*In re* Canelos), 216 B.R. 159 (Bankr. D. Md. 1997) (holding that $6,400 of creditor's $15,000 lien would survive as an encumbrance on the debtor's property); *In re* Ryan, 210 B.R. 7, 10-11 n.2 (Bankr. D. Mass. 1997); *see also* Carlson, *supra* note 86, at 67-69 (providing an example involving multiple qualifying liens). There is, however, some contrary authority that resolves the ambiguity by concluding that there is no difference between partial and total impairment, with the result being complete lien avoidance. *See, e.g.*, East Cambridge Sav. Bank. v. Silveira, No. 96-11388-WGY, 1997 U.S. Dist. LEXIS 11065 (D. Mass. June 30, 1997), *vacated and remanded*, 141 F.3d 34 (1st Cir. 1998); *see also Finn*, 211 B.R. at 784 (DeJesus, J., dissenting) (relying on *Thomsen*, even though the court in that case did not resolve the issue).

140. This is because the formula calls for all nonavoidable liens to be taken into account in determining whether the debtor has any equity in the property. In the absence of equity above the sum of consensual liens, the judicial lien is effectively reduced to zero or, to use the terminology developed under section 506(d), 11 U.S.C. § 506(d) (1994), stripped. *See* Ponoroff & Knippenberg, *supra* note 37, at 2244-46 (discussing section 522(f)(2)(A) as an incursion on the Supreme Court's decision in *Dewsnup v. Timm*, 502 U.S. 410 (1992), prohibiting lien stripping in chapter 7 cases).

141. *See supra* note 139.

can be preserved for the debtor pursuant to section 522(i)(2)[142] and, by analogy, section 551.[143] The legislative history,[144] however, leaves no doubt as to Congress's intent to adopt Judge Becker's position expressed in the dissenting opinion of *Simonson v. First Bank of Greater Pittson (In re Simonson)*[145] that section 522(i) should be read to permit the debtor to preserve the avoided transfer for the benefit of his exemption.[146] This explanation, coupled with the spirit of the new statutory provision,[147] strongly indicates that the junior lien should not spread and consume the value created by avoidance of the judicial lien.[148]

Although it is less overtly obvious, section 522(f)(2) also overruled the stilted reading of *Owen* taken by the Sixth Circuit in *Moreland.*[149] By focusing on the dollar value of the exemption rather then the more ambiguous question of whether the property is itself exempt,[150] several cases decided after the effective date of the 1994 Amendments recognized that the new definition of impairment negated the Sixth Circuit's view that a judicial lien on property cannot impair an exemption where applicable state law only provides for an exemption when the property is the subject of an involuntary execution.[151] Recently, in *Star Bank,*

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142. 11 U.S.C. § 522(i)(2) (1994).

143. 11 U.S.C. § 551 (1994); *see supra* notes 117-23 and accompanying text.

144. 1994 HOUSE REPORT, *supra* note 135, at 53-54:

> This amendment also overrules *In re Simonson,* 758 F.2d 103 (3d Cir. 1985), in which the Third Circuit Court of Appeals held that a judicial lien could not be avoided in a case in which it was senior to a nonavoidable mortgage and the mortgages on the property exceeded the value of the property. The position of the dissent in that case is adopted.

145. 758 F.2d 103 (3d Cir. 1985).

146. *See id.* at 112; *supra* notes 121-23 and accompanying text.

147. *See In re* VanZant, 210 B.R. 1011, 1014 (Bankr. S.D. Ill. 1997) (commenting on the "prodebtor" approach of the new section 522(f)(2)); Carlson, *supra* note 86, at 74 (same).

148. *See* Howard, *supra* note 18, at 277 (noting that even if the legislative history is not alone persuasive, the majority in *Simonson* was wrong to begin with and that, after the 1994 Amendments, "only a stubborn court is likely to follow it now").

149. Resolution Trust Corp. v. Moreland (*In re* Moreland), 21 F.3d 102 (6th Cir. 1994); *see supra* text accompanying notes 87-94. The legislative history does, however, explicitly provide that the 1994 Amendments to section 522 were intended to overrule the Sixth Circuit's decision in *Ford Motor Credit Corp. v. Dixon (In re Dixon),* 885 F.2d 327 (6th Cir. 1989). *See supra* text accompanying notes 52-55; *see also In re* Richardson, 224 B.R. 804 (Bankr. N.D. Okla. 1998) (discussing the applicable legislative history).

150. *See* 1994 HOUSE REPORT, *supra* note 135, at 53.

151. *See, e.g., In re* Allard, 196 B.R. 402, 410-11 (Bankr. N.D. Ill. 1996), *aff'd sub nom.* Great S. Co. v. Allard, 202 B.R. 938 (N.D. Ill. 1996) (holding that after the 1994

N.A. v. Holland (In re Holland), the Sixth Circuit itself finally conceded the point, holding that, pursuant to the 1994 Amendments, it is no longer appropriate to look to state law to determine if a lien impairs an exemption.[152] Although the court stopped short of acknowledging that *Owen* stood for the same proposition and that, therefore, its decision in *Moreland* had been wrong to begin with, it did admit that the *Holland* result was consistent with the purposes of federal bankruptcy law.[153]

Disturbingly, however, courts in other circuits occasionally continue to give effect to the content of state exemption law. For example, in *In re Fracasso*,[154] the debtor claimed a homestead exemption for the equity in her residence, an amount that exceeded the sum of unsecured claims against her estate. Massachusetts law provides for a maximum homestead exemption of $100,000, but acquisition of the homestead status requires the filing of a declaration with the county Registry of Deeds. Moreover, the pertinent statute makes the exemption ineffective against debts contracted prior to the recording of this declaration. In this case, all of the debtor's debts were incurred prior to the recording of her declaration of homestead. Thus, the bankruptcy trustee objected to the asserted exemption, claiming that the debtor's residence was subject to administration. The debtor contended that, pursuant to section 522(c),[155] state-created exceptions to state exemptions are prohibited. Parting with prior

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Amendments, it is irrelevant to the question of impairment that Illinois law requires the homestead amount to be paid off as part of a forced sale); *see also* Public Serv. Employees Credit Union v. Pepper (*In re* Pepper), 210 B.R. 480, 484-85 (Bankr. D. Colo. 1997). The lower courts in the Sixth Circuit had split on the issue of whether *Moreland*, 21 F.3d 102 (6th Cir. 1994) is still good law, and have begun to question the viability of the *Moreland* opinion itself. *See In re* Miller, 198 B.R. 500, 503 (Bankr. N.D. Ohio 1996) (holding that, based on the legislative history of the 1994 Amendments, it is evident that *Moreland* and *Dixon* were contrary to Congress's intent); *In re* Jakubowski, 198 B.R. 262, 263 (Bankr. N.D. Ohio 1996) (holding that *Moreland* and *Dixon* were overruled by the 1994 Amendments). *But see In re* Colston, 213 B.R. 704, 708 (Bankr. S.D. Ohio 1997) (ruling that *Moreland* and *Dixon* remain good law even after the 1994 Amendments). Eventually, the Sixth Circuit resolved the issue by acknowledging that, indeed, after the 1994 Amendments, *Moreland* was no longer good law. *See* Star Bank, N.A. v. Holland (*In re* Holland), 151 F.3d 547 (6th Cir. 1998); *see infra* text accompanying notes 152-53.

152. *See Holland*, 151 F.3d 547.

153. *See id.* at 11 (citing *In re* Miller, 198 B.R. 500, 505 (Bankr. N.D. Ohio 1996)).

154. 210 B.R. 221 (Bankr. D. Mass. 1997).

155. 11 U.S.C. § 522(c) (1994).

district precedent established in *In re Boucher*,[156] in *Fracasso*, the court held that neither *Owen* nor section 522(c) restricts the right of the state, "as reserved to the state by Congress, to craft its Homestead Statute with an exception for prehomestead debts." Shortly after *Fracasso* was decided, however, in *In re Whalen-Griffen*,[157] the United States Bankruptcy Court for the District of Massachusetts upheld the reasoning in *Boucher*, concluding that exempt property, whether exempted under state or federal law, can only be liable for the types of debt set forth in section 522(c).[158] That is, although a state can place limits on the dollar amount of an exemption, it can no more define the exemption with reference to obligations not identified in section 522(c) than it can exclude certain obligations from the exemption for purposes of section 522(f)(1). This conclusion is consistent with the Supreme Court's finding in *Owen* that there is no basis for treating the state and federal exemptions differently, and also suggests that *Moreland* was incorrectly decided even before the 1994 Amendments.

B. Limitations on Lien Avoidance: Section 522(f)(3)

After *Owen*, except perhaps for a brief period in the Sixth Circuit, it was clear that although states might control what property was exempt, federal law determined the availability of lien avoidance.[159] In states, such as Texas, with relatively high personal property exemptions, some or all of which might be allocated to a debtor's tools of the trade, creditors feared that,

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156. 203 B.R. 10 (Bankr. D. Mass. 1996).

157. 206 B.R. 277 (Bankr. D. Mass. 1997); *see also* Bruin Portfolio, LLC v. Leicht (*In re* Leicht), 222 B.R. 670 (B.A.P. 1st Cir. 1998) (holding that a judicial lien that encumbers a Massachusetts homestead may be avoided even if it secures a preacquisition contract debt).

158. *See* 206 B.R. at 290-91. A similar split of authority has recently developed in Oklahoma. *Compare In re* McKinney-Jones, 219 B.R. 619 (Bankr. W.D. Okla. 1998) (holding that a judicial lien did not impair the debtor's state law homestead exemption, protecting such property from "forced sale," because it did not interfere with her right "to live in the home without it being sold"), *with In re* McMasters, 220 B.R. 419 (Bankr. N.D. Okla. 1998) (disagreeing with *McKinney-Jones* on the basis that, after *Owen* built-in state limitations on exemptions are inoperative insofar as the debtor's rights under section 522(f) are concerned).

159. *See, e.g., supra* note 87; *see also In re* Shipman, 167 B.R. 527, 529 (Bankr. N.D. Ind. 1994) (noting that, under *Owen*, "states may not define exemptions in such [a] way as to defeat a debtor's rights under § 522(f)"); *In re* Nash, 142 B.R. 148, 153 (Bankr. N.D. Tex. 1992).

under *Owen*, section 522(f) might be employed to set aside true reliance liens. Therefore, in an act that at the time seemed more symbolic than substantive, the Texas legislature amended the State's Property Code in 1993 to prohibit avoidance of security interests on the ground that the property is exempt.[160] The exercise was not, however, as pointless as it might in isolation have appeared because earlier in the same year United States Representative William C. Sarpalius of Texas introduced a bill titled the "Secured Credit Availability Act of 1993," which proposed to amend section 522 by adding a new subsection:

> The debtor may not 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)(2), if—
> (A) such lien is a nonpossessory, nonpurchase-money security interest in any tools of the trade, implements, animals, or crops; and
> (B) the State law referred to in such subsection prohibits the debtor from avoiding the fixing of such lien to such extent.[161]

Had the Sarpalius bill been enacted into law in the form originally introduced, it would have carved out a significant exception to the rule in *Owen*, precluding Texas debtors who elected their state exemptions from avoiding any consensual liens on the collateral defined in subparagraph (A).[162]

In fact the bill was never reported out of committee, but the substance of the proposal found its way into the Senate version of

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160. Specifically, section 42.002(b) of the Texas Property Code was amended, effective May 17, 1993, to add the language, "and the security interest or lien may not be avoided on the ground that the property is exempt under this chapter." TEX. PROP. CODE ANN. § 42.002(b) (West Supp. 1998). At the time of enactment, this limitation had no effect since, under *Owen*, any state law restriction on avoidability was overridden by the debtor's nonwaivable right to set aside qualifying liens under then sections 522(f)(1)-(2).

161. H.R. 339, 103d Cong. (1993).

162. Texas debtors would have been in a particularly difficult position because, in 1991, Texas doubled its already generous personal property exemption in section 42.001 of the Texas Property Code and amended section 42.002(a)(4) of the Texas Property Code to include motor vehicles within the definition of tools of the trade. Texas also eliminated the requirement that for property to be considered a tool of the trade, it must be "peculiarly adapted" to the debtor's trade or profession in favor of a "fairly belonging to or usable in the debtor's trade" standard. *In re* Erwin, 199 B.R. 628, 630 (Bankr. S.D. Tex. 1996) (quoting *In re* Nash, 142 B.R. 148, 152 (Bankr. N.D. Tex. 1992)); *see also In re* Legg, 164 B.R. 69 (Bankr. N.D. Tex. 1994).

the legislation that culminated in the 1994 Amendments. Specifically, section 313 of the Bankruptcy Amendments Act of 1994, as passed by the Senate on April 21, 1994, provided:

> In a case in which State law that is applicable to the debtor—
>
> (A) permits a person to voluntarily waive a right to claim exemptions under subsection (d) or prohibits a debtor from claiming exemptions under subsection (d); and
>
> (B) permits the debtor to claim exemptions under State law without limitation in amount, except to the extent that the debtor has permitted the fixing of a consensual lien on any property,
>
> the debtor may not avoid the fixing of a lien on an interest of the debtor or a dependent of the debtor in property if the lien is a nonpossessory, nonpurchase-money security interest in implements, professional books, or tools of the trade of the debtor or a dependent of the debtor or farm animals or crops of the debtor or a dependent of the debtor.[163]

This provision would have had the effect of overruling *Owen* with respect to the referenced small-business and agricultural collateral in states like Louisiana that exempted tools of the trade and related property without limitation.[164] However, unlike the Sarpalius bill, the Senate bill failed to provide any protection to lenders in states like Texas that placed at least some dollar limitation, no matter how high, on exemptible tools, books, equipment, and other items used in a trade or profession. Accordingly, representatives of the credit and banking industries lobbied the House of Representatives to include in the final version of the bill an alternative mechanism in subparagraph (B) for triggering the restriction on lien avoidance.[165] Specifically, as in the Sarpalius bill, the limitation on the debtor's avoiding power would pertain in the event either state law permitted the exemption without limitation or state law prohibited the avoidance of a consensual lien on property otherwise eligible to be claimed as exempt. The effort resulted in inclusion of the

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163. S. 540, 103d Cong. § 313 (1994).

164. *See supra* note 59.

165. *See In re* Ehlen, 202 B.R. 742 (Bankr. W.D. Wis. 1996), *aff'd*, 207 B.R. 197 (W.D. Wis. 1997) (summarizing the efforts of the credit industry in Congress to reverse what was perceived as the inequities occasioned by *Owen*).

requested language in the House bill and eventually the 1994 Amendments.[166]

In an unexpected turn of events, however, the House bill contained an additional provision, not reflected anywhere in its companion bill in the Senate that limited the new restriction on the debtor's avoiding power "to the extent that the value of such implements, professional books, tools of the trade, animals, and crops exceeds $5,000."[167]

C. *Unpacking the Verbiage*

Before attempting to parse out the meaning and put into some perspective the serpentine phraseology employed in section 522(f)(3), it is important to remember that the 1994 revisions to section 522 relating to the definition of impairment were intended to expand the application of the debtor's lien avoidance powers in order to facilitate the fresh start notion that is central to federal bankruptcy law. As originally conceived, section 522(f) evinced Congress's concern over what it viewed as overreaching and even unconscionable credit practices utilized in the consumer lending industry.[168] Still, although it is neither unreasonable nor illogical to suggest that a somewhat different set of rules ought to govern lien avoidance when the property in question involves Tools of the Trade rather than Consumer or Medical Appliances Collateral, section 522(f)(3), which the legislative history cryptically describes as "a limited exception to the debtor's ability to avoid nonpossessory, nonpurchase-money security interests,"[169] flies in the face of this resuscitation of the fresh start.

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166. *See* 1994 HOUSE REPORT, *supra* note 135, at 56-57 (indicating an intent to add a "*limited* exception to the debtor's ability to avoid nonpossessory nonpurchase-money security interests in implements, professional books, or tools of trade of the debtor or a dependent of the debtor, or farm animals or crops of the debtor or a dependent of the debtor" (emphasis added)).

167. 11 U.S.C. § 522(f)(3)(B) (1994). For the full text of the provision as enacted under section 310 of the 1994 Amendments, see *supra* text accompanying note 18. Significantly, by its terms, section 522(f)(3)'s limitation on the debtor's avoiding power pertains only to consensual liens under section 522(f)(1)(B), and not judicial liens that could conceivably encumber the same property, particularly in states such as California, that permit liens against personal as well as real property to be created by recordation of the lien.

168. *See supra* note 128; 1978 HOUSE REPORT, *supra* note 128, at 126-27, *discussed in* Finance One, Inc. v. Hall (*In re* Hall), 752 F.2d 582 (11th Cir. 1985).

169. *See* 1994 HOUSE REPORT, *supra* note 135, at 56.

As early as 1989, in *In re Thompson*,[170] the Seventh Circuit observed that the drafters of the Bankruptcy Code may have overlooked the impact of the section 522 lien avoidance provisions in states with generous tools of the trade or generic personal property exemptions; thus allowing debtors in commercial cases to shield substantial assets from administration.[171] As noted earlier, however, most small-business debtors are not terribly dissimilar by dint of their financial circumstances from the prototypical consumer debtor.[172] This fuzzy line of demarcation corresponds with the similarly blurry distinction between consumer goods and tools of a debtor's trade or profession, particularly in the case of self-employed individuals. Therefore, the argument that section 522(f) as originally drafted was overly broad, although not without some merit, can easily be overstated, as may indeed have been the case in some of the rhetoric leading to the adoption of section 522(f)(3).[173] In the final analysis, however, we cannot even begin to assess how effective new section 522(f)(3) is in discriminating between the different policy aims of consumer versus business bankruptcies without first attempting to divine from the tortured language[174] of the provision when and to what extent this limitation is operative.

1. Subparagraph (A)

To begin with, because subparagraphs (A) and (B) of section 522(f)(3) are joined by the conjunctive connector "and," both criteria must be satisfied before the limitation on the debtor's avoiding powers in subsection (f)(3) comes into play. Between the

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170. 867 F.2d 416 (7th Cir. 1989).

171. *See id.* at 421; *see also* Carlson, *supra* note 86, at 58 (noting that section 522(f) has permitted debtors to avoid very large security interests on expensive items of personalty by establishing that the property qualified as tools of the trade).

172. *See supra* note 19.

173. *See* 140 CONG REC. S4644-45 (daily ed. Apr. 21, 1994) (statement of Sen. Johnston) (concerning the detrimental effect of *Owen* on agricultural borrowers).

174. In referring to another new provision added by the 1994 Amendments, section 523(a)(15), 11 U.S.C. § 523(a)(15) (1994) (relating to property settlements claims arising out of divorce proceedings), the court in *Kessler v. Butler* (*In re Butler*), 186 B.R. 371, 373 (Bankr. D. Vt. 1995), noted that Congress, by employing the "use of triple negatives in this subsection has turned an otherwise well intended statute into sausage." Although it is less clear how well-intended section 522(f)(3) is, if section 523(a)(15) is sausage, section 522(f)(3) is mashed potatoes.

two, the terms of subparagraph (A) are the most difficult to cipher. Specifically, subparagraph (A) requires that the state law applicable to the debtor must either: (1) permit a person to voluntarily waive a right to claim exemptions under section 522(d);[175] or (2) prohibit a debtor from claiming exemptions under subsection (d).

Despite the clumsy expression, it seems likely that the second of these two alternatives refers to opt-out states, those that have exercised the option under section 522(b)[176] to enact legislation relegating debtors in those jurisdictions to their applicable state and other nonbankruptcy federal exemptions.[177] As a non-opt-out jurisdiction, Texas, for example, would not satisfy this requirement.

The first alternative for complying with subparagraph (A), requiring that applicable state law permit a person voluntarily to waive a right to claim exemptions under section 522(d), is even more enigmatic since Code section 522(e)[178] expressly makes waivers of exemptions unenforceable.[179] The idea that Congress would establish adoption of a state law that is repugnant to bankruptcy ideals as a standard for satisfying this aspect of the test is highly unlikely. Moreover, the majority of states do not speak to waivers of exemptions at all; and, to the extent they do, it is ordinarily in the context of recognizing the priority of consensual liens over applicable state exemption laws.[180] Since the matter is otherwise resolved as a matter of private contract, the few states that do address waivers of exemptions in connection with unsecured credit contracts typically focus on the enforceability or nonenforceability of such provisions on public

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175. 11 U.S.C. § 522(d) (1994).

176. 11 U.S.C. § 522(b) (1994).

177. *See* 11 U.S.C. § 522(b)(2) (1994). This then would include the majority of the states. *See supra* note 26. A complete list of opt-out and non-opt-out states can be found in Appendix II to Brown, *supra* note 21, at 218.

178. 11 U.S.C. § 522(e) (1994).

179. That section provides, in pertinent part that: "A waiver of an exemption executed in favor of a creditor that holds an unsecured claim against the debtor is unenforceable in a case under this title with respect to such claim against property that the debtor may exempt under subsection (b) of this section." 11 U.S.C. § 522(e) (1994).

180. *See, e.g.*, TEX. PROP. CODE ANN. § 42.001(c) (West 1984 & Supp. 1998) ("This section does not prevent seizure by a secured creditor with a contractual landlord's lien or other security in the property to be seized.").

policy grounds.[181] Therefore, one would expect that if a state did not have a strong policy-based objection to such waivers, there would be no need to speak to the issue in the first place. Accordingly, it is difficult to imagine that this first alternative of subparagraph (A) would ever be met.

As a result, there is a strong possibility that the first prong of subparagraph (A) must refer to a different circumstance than a state law affirmatively authorizing its domiciliaries to waive their federal bankruptcy exemptions. One possibility would be that the language "permits a person to voluntarily waive a right to claim exemptions under subsection (d)" was intended to refer to the situation where state law permits the debtor to select between the state and federal exemptions.[182] The problem, of course, with this construction is that the two alternatives would then together encompass every state, making the inclusion of subparagraph (A) unnecessary in the first place.[183] A variation on this approach, which avoids rendering subparagraph (A) wholly meaningless would be to read the first instance as applying in non-opt-out jurisdictions, such as Texas, but only when the debtor has actually elected her state law exemptions in lieu of the exemptions provided in subsection (d). This construction, which finds some support in the legislative history,[184] is problematic on

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181. *See* DAVID G. EPSTEIN & STEVE H. NICKLES, DEBT: BANKRUPTCY, ARTICLE 9 AND RELATED LAWS 34 (1994), where the authors state:

> The exemption laws of a few states authorize the waiver of some or all exemption clauses. The statutes of other states condemn such a waiver. The enacted laws of most states are silent on the waiver issue; but the well-established general rule is that, except where expressly provided otherwise by enacted law, executory waivers of exemptions are void. They offend public policy.

In fact, no states expressly approve of a waiver of exemptions in connection with an *unsecured* credit contract.

182. *In re* Parrish, 186 B.R. 246, 247 (Bankr. W.D. Wis. 1995) (quoting section 522(f)(3) (1994) and essentially adopting this view). *But see In re* Zimmel, 185 B.R. 786, 790 (Bankr. D. Minn 1995); *infra* text accompanying notes 209-16.

183. *See In re* Ehlen, 202 B.R. 742, 746 (Bankr. W.D. Wis. 1996) (noting that the *Parrish* analysis of subpart (A) renders the provision applicable to all debtors who utilize state exemptions), *aff'd*, 207 B.R. 179 (W.D. Wis. 1997). It also violates the general canon of construction against construing any one provision of a statute in a manner that renders another provision meaningless. *See, e.g.*, Pennsylvania Dep't of Pub. Welfare v. Davenport, 495 U.S. 552, 562 (1990) ("Our cases express a deep reluctance to interpret a statutory provision so as to render superfluous other provisions in the same enactment." (citation omitted)).

184. *See* 1994 HOUSE REPORT, *supra* note 135, at 56-57 (suggesting that subsection (3) is intended to apply where the debtor has elected or, by virtue of the state's exercise of its opt-out power, is required to have her exemptions determined

at least two grounds. First, the language in question really says nothing of the kind. Second, this construction is radically inconsistent with the way in which section 522(b)(2)[185] is formulated. That is to say, the election between state and federal exemptions is the rule *unless* the state passes legislation to opt-out. Thus, state law applicable to the debtor might preclude a debtor from claiming exemptions under subsection (d), but there would never be a reason for it to permit the debtor to waive those exemptions since that right exists independent of state law.[186] Hence, the language in the first part of subparagraph is an ineluctable non sequitur.

2. Subparagraph (B)

The criteria for satisfying subparagraph (B) of section 522(f)(3) are also offered in the alternative. The limitation on lien avoidance pertains if the state law applicable to the debtor either: (1) permits the debtor to claim exemptions without limitation; or (2) prohibits avoidance of a consensual lien on property otherwise eligible to be claimed as exempt.[187] Quite obviously, the second circumstance pertains to states such as Texas that, apparently anticipating enactment of something akin to subsection (f)(3), have adopted a "no lien avoidance" statute as part of their state law.[188] However, it is unclear from the language employed how explicit the state rule must be in order to satisfy the second prong of subparagraph (B). For instance, if applicable state law simply defines exempt property exclusive of property subject to a

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under state law rather than section 522(d), 11 U.S.C. § 522(d) (1994)).

185. 11 U.S.C. § 522(b)(2) (1994).

186. *See* 11 U.S.C. § 522(b)(2)(A) (1994).

187. This rendering assumes a comma in the statute where none actually exists; before the phrase "or prohibits avoidance of a consensual lien on property otherwise eligible to be claimed as exempt property." 11 U.S.C. § 522(f)(3)(B) (1994). Although subparagraph (B) makes no sense without inserting that comma, doing so entails a certain amount of peril. *See In re* Dan-Ver Enters., 67 B.R. 951 (W.D. Pa. 1986) (discussing "the case of the capricious comma" in connection with the proper interpretation of another section of the Code, section 506(b), 11 U.S.C. § 506(b) (1994)). That issue was ultimately resolved only after a trip to the United States Supreme Court, producing a five-to-four decision attempting to divine how much significance to place on the "adroit use of a comma." United States v. Ron Pair Enters., 489 U.S. 235, 249-51 (O'Connor, J., dissenting).

188. *See supra* note 161. The significance of the Texas statute in relation to section 522(f)(3) was interpreted in *In re Duvall*, 218 B.R. 1008 (Bankr. W.D. Tex. 1998). *See infra* notes 239-57 and accompanying text.

consensual lien, as many do,[189] or subordinates the exemption to the claim of a creditor who holds a security interest in the property, is that sufficient? Although lien avoidance must mean something quite different from the recognition that an exemption can only attach to that portion of the debtor's interest in the property that has not been voluntarily alienated, there is disagreement in the courts over the proper interpretation of this provision.[190]

Thus, although the second prong of subparagraph (B) is not free from doubt, the first part is even more opaque. It applies when the debtor can claim exemptions under state law without limitation in amount. Presumably, the property subject to unlimited exemption is intended to refer to the "implements, professional books, or tools of the trade of the debtor," which are the ultimate focus of subsection (f)(3). Once again, however, that connection must be read into the statute and, under a plain language approach, this aspect of subparagraph (B) could arguably be satisfied as long as *any* state exemptions are absolute. A literal reading of the language might also provide that *all* categories of exempt property in the state must be available without monetary limitation, in which case no state's law would satisfy this prong of the standard.[191]

In sum, while perhaps less mysterious, subparagraph (B) is no less ambiguous than subparagraph (A) in terms of what criteria must be met and what it takes to satisfy them. However, even this ambiguity pales in comparison with the uncertainty surrounding calculation of the restriction on subsection (f)(3)'s limitation on the debtor's avoiding powers created by reference to the $5,000 value at the end of that provision.

3. The $5,000 Threshold

Assuming that subparagraphs (A) and (B) of section 522(f)(3) are both satisfied, and the collateral at issue consists of implements, professional books, tools of the trade, farm animals,

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189. *See supra* notes 49-62.

190. *See infra* text accompanying notes 269-70.

191. The exemption laws of the several states are collected in volume 7 of Collier on Bankruptcy, which confirms the obvious point that no state would fall into this category. *See* 7 MARK I. BANE ET AL., COLLIER ON BANKRUPTCY (Lawrence P. King et al. eds., 15th ed. 1998).

or crops, the last paragraph of subsection (f)(3) provides that the debtor may not avoid a consensual lien, even though determined to impair an exemption, to the extent that the value of such collateral exceeds $5,000. The provision is nearly unintelligible and, therefore, not surprisingly, replete with interpretive uncertainty. To begin with, does the $5,000 threshold apply to each item of qualifying collateral, each category of qualifying collateral, or all qualified collateral? Since the last sentence in subsection (f)(3) connects the various kinds of collateral with the inclusive conjunction "and," the most rational conclusion is that the collateral is bundled for valuation purposes, as long as all such property is exempt and subject to the same security interest. However, because early in the same paragraph a verbal distinction is drawn between the trade and professional collateral, on the one hand, and the farm collateral, on the other, one might also reasonably infer that they are to be separated for valuation purposes so that the debtor can protect up to $5,000 in each type of collateral, even if all of the collateral is subject to a single creditor's nonpossessory, nonpurchase-money security interest. The issue is not as theoretical as it might seem because although most nonfarmers are unlikely to both own and encumber both types of collateral, just the opposite is true for most farm borrowers. Further complicating the picture is the fact that, as discussed more fully below,[192] the rationale for including farm collateral in the first place may be flawed.

Congress's aim in restricting application of section 522(f)(3) to property with a value in excess of a specified amount, was presumably to ensure that, regardless of this new restriction on lien avoidance, a minimum amount of this type of property was "freed up" and available to prime the debtor's fresh start.[193] The

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192. *See infra* notes 290-91 and accompanying text..

193. *See* 1994 HOUSE REPORT, *supra* note 135, at 57 (suggesting that the debtor may not avoid a security interest on the specified property *to the extent* the value of such property is in excess of $5,000). Interpreting the highlighted language as limiting the creditor's ability to avoid avoidance under subsection (f)(3), the language implies that the impairing lien can be avoided as to the portion of the property that is less than $5,000 in value. *See In re* Weinstein, 192 B.R. 133, 136 (Bankr. E.D. Va. 1995) (suggesting in dictum that as long as the property does not exceed $5,000, the debtor may avoid a nonpurchase-money, nonpossessory security interest against the property). Still this construction, although sensible, is not without problems. First, it implies that this language may also suggest that in cases where the specified property exceeds $5,000 in value, the lien may not be avoided at all, even though there is no rational policy basis for discriminating against debtors whose exempt

problem is that although subsection (f)(3) focuses on the dollar value of the collateral, subsections (f)(1) and (f)(2) continue to focus on the amount of the liens or the exemptions. Therefore, applying section 522(f) as a whole now requires controlling for multiple inconsistent values, an exercise almost guaranteed to produce chaos in the courts.[194]

Consider, for example, a debtor who has granted an $11,000 nonpossessory, nonpurchase-money security interest in her exempt professional books, valued at $7,500. Assume that subparagraphs (A) and (B) of subsection 522(f)(3) are satisfied because the debtor resides in an opt-out state and the relevant state law provides a profesional books, implements, or tools of the trade exemption for $7,500, but prohibits the avoidance of consensual liens on such property. Under the formula in subsection (f)(2), the amount of the lien ($11,000) plus the amount of the exemption ($7,500), less the value of the property if there were no liens ($7,500), equals the full amount of the lien ($11,000). Therefore, the entire lien impairs and can be avoided, subject to the limitation in subsection (f)(3).[195] Section 522(f)(3), in turn, preserves the lien to the extent that value of the property exceeds $5,000; but what does that mean?

Perhaps the most extreme view would be that since the value of the property exceeds $5,000, the requirement in subsection (f)(3) is met and the entire lien survives.[196] This would require

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property exceeds a designated amount. Second, the Supreme Court recently decided not to read the phrase "to the extent obtained by" language in section 523(a)(2), 11 U.S.C. § 523(a)(2) (1994), as limiting the nondischargeable portion of a debt to the value of any money, property, or services obtained by fraud, rather than more broadly to any damages, compensatory and punitive, assessed on account of the fraud. *See* Cohen v. De La Cruz, 118 S. Ct. 1212 (1998). Finally, the drafters of the 1994 Amendments neglected to include the $5,000 figure in section 104(b), 11 U.S.C. § 104(b) (1994), which calls for an automatic inflationary adjustment every three years of, among other dollar amounts, all of the exemption levels in section 522(d), 11 U.S.C. § 522(d) (1994). *See* Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106 (codified as amended in scattered sections of 11 U.S.C., 12 U.S.C., 18 U.S.C., and 28 U.S.C.). This leaves the figure limitation in section 522(f)(3) static regardless of future inflation.

194. For other possible constructions of how subsection (f)(3) might operate, see Everett, *supra* note 132, at 1351-56.

195. Note that this result occurs because subsection (f)(2), in calculating the extent to which the lien is considered to impair, focuses in the first instance on the dollar values of the exemption and the lien. As noted, section 522(f)(3) focuses solely on the value of the collateral in determining the extent to which the debtor's right to avoid the impairing lien is curtailed.

196. *See infra* note 247.

reading the language as providing that if the value of the specified collateral exceeds $5,000, the debtor's right to nullify the lien is simply canceled. Although plausible, this construction hardly seems consistent with the articulated reason behind the limitation or with the view that the language "to the extent that" implies a limitation rather than a condition precedent.[197] Another view might be that only $6,000 of the lien can be avoided, because that is the amount by which the secured indebtedness exceeds the $5,000 threshold; in other words, the lien is *not* avoidable to the extent of $5,000. The obvious problem with this conclusion is that it blatantly ignores the fact that under the plain statutory language it is the value of the property and not the amount of the claim that is supposed to control. A somewhat related approach would be to permit avoidance only to the extent of $5,000, leaving, in the hypothetical posed above, $6,000 rather than $5,000 of the lien intact.[198] Of course, in addition to having done virtually nothing for the debtor,[199] this technique relates the $5,000 to something other than the value of the property. A more sensible, but not immediately obvious, interpretation is that since the value of the property exceeds $5,000 by $2,500, the lien is only avoidable to the extent of $8,500,[200] meaning that $2,500 of the

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197. *See supra* note 193; *see also* Fidelity Guar. Ins. Co. v. Corson (*In re* Corson), 206 B.R. 17, 22 (Bankr. D. Conn. 1997) (rejecting the proposition that the phrase "to the extent that" should be read to mean "if" in the context of section 522(f)(1)(A)). A similar interpretational problem exists under section 547(c)(4), 11 U.S.C. § 547(c)(4) (1994), the so-called subsequent advance defense to the trustee's preference recovery powers, although the statute has not been construed in that fashion. *See* Lawrence Ponoroff, *Evil Intentions and an Irresolute Endorsement for Scientific Rationalism: Bankruptcy Preferences One More Time,* 1993 WIS. L. REV. 1439, 1459 n.48.

198. *See In re* Parrish, 186 B.R. 246 (Bankr. W.D. Wis. 1995); *infra* text accompanying notes 217-30.

199. Indeed, if the debt were $13,500 or more, it would completely deprive the debtor of any value in the property. It is difficult to fathom a principle that would support an interpretation of subsection (f)(3) that made the question of whether the debtor emerged from bankruptcy with any exempt property turn on the serendipity of the size of the undersecured portion of the security interest. In fact, it would be particularly ironic were the courts to adopt such a construction of a provision added to the Code at the same time that Congress finally clarified that underwater liens do impair because otherwise the creditor could threaten postbankruptcy execution or, at a minimum, appropriate the benefit of postbankruptcy appreciation that is supposed to be protected by the fresh start. *See* 1994 HOUSE REPORT, *supra* note 135, at 53.

200. *See* Everett, *supra* note 132, at 1355-56 (suggesting an interpretation something like this, but concluding that it is totally unsupportable on the language of the statute). Everett's view is predicated on the belief that a strict reading of

impairing lien is not avoidable within the meaning of subsection (f)(3) and, therefore, is preserved. As a result, at least on these facts, the debtor exits bankruptcy with $5,000 of equity in the exempt property, which seems to be consistent with the compromise Congress was apparently seeking to strike with respect to this type of collateral by simultaneously adopting subsections (f)(2) and (3).

The weakness with this last analysis—which essentially involves subtracting $5,000 from the value of the subsection (f)(3) collateral, and then limiting avoidance of an impairing lien to the difference between the lien and that amount—is first revealed when we introduce an impairing nonavoidable lien. For instance, assume in the above example that the property in question is also subject to a $5,000 purchase-money security interest. The value of the property still exceeds $5,000 by $2,500, which is the portion of the avoidable lien that is now made nonavoidable by subsection (f)(3). The result, however, is that the debtor exits bankruptcy with no equity in the property over and above the sum of the unavoided liens. The same unintended result occurs if the statute is construed to apply in circumstances where the offending lien only partially impairs in the first place.[201]

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subsection (f)(3) requires that the amount that is not avoidable under subsection (f)(3) ($2,500) is subtracted from the extent to which the security interest impairs, as determined under subsection (f)(2) ($11,000), with the balance ($8,500) remaining as a lien on the property. This results, of course, in the property emerging from the bankruptcy in the same condition it went in, namely overencumbered. *See id.* at 1354 (noting that this approach would create the somewhat perverse incentive for debtors to devalue, and creditors to urge higher values, for the exempt property). Although not necessarily affecting the parties positions on valuation, this interpretation is not mandated by the language of the subsection (f)(3), which seems to say that the portion of the $11,000 impairing lien that is *not* avoidable is limited to the difference between the value of the property and $5,000 ($2,500); the remaining portion of the lien ($8,500) is avoidable (or not *not* avoidable). *See infra* note 250.

201. Professor Carlson points out that this analysis breaks down when the lien only partially impairs. *See* Carlson, *supra* note 86, at 80-81. He posits the example of a debtor with a vehicle (qualifying as a tool of the trade) with a value of $50,000, subject to a $100,000 lien and entitled to an exemption of $2,400. On these facts, Carlson calculates the impairment under subsection (f)(2), and the amount that is avoidable, as $52,400 ($102,400 - $50,000). The portion of the avoidable amount that is protected by subsection (f)(3) is then the difference between the value of the property and $5,000, or $45,000. Because the lien is not avoidable to that extent—$45,000—Carlson deducts that amount from $52,400, leaving $7,400 as avoidable. The effect, of course, is that $92,600 of the lien survives, wholly swallowing the value of the vehicle and then some. However, since the amount that is not avoidable ($45,000) is less than the portion of the lien that would have

The second weakness in the analysis is that it ignores the reality that if the lien remains on the property to any extent after partial avoidance, the practical effect in most cases is that the debtor will never receive a penny from the property unless the valuation for section 522(f)(3) purposes takes into account the notoriously low prices received in forced sales.[202] Although the standard of valuation used under subsection (f)(3) has yet to be addressed, the logic of the Supreme Court's decision in *Associates Commercial Corp. v. Rash*[203] leads to the unfortunate conclusion that the high valuation "replacement cost" approach will likely apply. In *Rash*, the Court determined that in valuing collateral under Code section 506(a),[204] bankruptcy courts are required to look to the "purpose of the valuation and of the proposed disposition or use of the property."[205] Because in *Rash* the issue arose in the context of the confirmation of a chapter 13 plan under which the debtor proposed to retain the property, the Court deferred to that use and held that replacement value (less certain

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survived anyway ($47,600), subsection (f)(3) should not limit or otherwise affect the extent of the debtor's avoiding power because the debtor is emerging from bankruptcy with exempt tools of the trade in an amount that is the lesser of $5,000 or the maximum exemption amount under state law. In other words, since the debtor is not avoiding a lien that permits the debtor to escape with more than $5,000 in exempt tools of the trade, the limitation in subsection (f)(3), which is intended to protect against exactly that result, is simply inoperative. This construction harmonizes the two new provisions of section 522. One of the major aims Congress had in mind in 1994 in defining impairment in the manner it did in subsection (f)(2) was to make clear that lack of equity should not be a bar to lien avoidance. *See* Copelco v. Choice (*In re* Choice), No. 97-15868DAS, 1997 Bankr. LEXIS 1493 (Bankr. E.D. Pa. Sept. 23, 1997). This goal was to assure debtors of a meaningful exemption in property subject to both types of qualifying liens. Therefore, it would be anomalous to construe subsection (f)(3), intended only as a limitation on the debtor's avoiding powers, in a manner that worked to deprive the debtor of any exemption at all because of lack of sufficient equity. Yet, that is exactly what happens in Carlson's example, and other cases like it, unless subsection (f)(3) is applied in a purposive manner mindful of the general principle that no provision of a statute should be construed in isolation. The problem, however, is that Carlson's construction of subsection (f)(3) as literally drafted is at least as plausible as the one offered above, particularly since, by virtue of the prefatory language in subsection (f)(2), subsection (f)(3) appears to operate as a limitation on impairment rather than as an alternative way to gauge the extent of avoidance in these circumstances. This is one more reason why that provision in its present form is untenable, if not outrageous.

202. *See* BFP v. Resolution Trust Corp., 511 U.S. 531, 537-38 (1994) (pointing out that forced sale value is not only irrelevant to a true test of market value, but is in fact the antithesis of market price).

203. 117 S. Ct. 1879 (1997).

204. 11 U.S.C. § 506(a) (1994).

205. *Id.* at 1885 (quoting Code section 506(a), 11 U.S.C. § 506(a) (1994)).

costs) was the appropriate valuation standard. By the same logic, when a debtor exercises her avoidance powers under section 522(f) with respect to exempt property that the debtor intends to retain, the higher replacement value approach should govern. Although there may be some logic to using replacement cost for appreciating assets (principally real estate), most items of personal property are likely to depreciate over time.[206]

The effect of incorporating a replacement value approach into the analysis under section 522(f) is devastating. In the original hypothetical, the debtor emerges from bankruptcy in possession of her exempt professional books, subject to a $2,500 security interest. The books have a replacement cost of $7,500, but unless the debtor is able to redeem immediately, they will be seized and sold by the secured creditor at a public or private sale (quite likely for no more than $2,500 less the creditor's costs of foreclosure, but nonetheless in full compliance with state law requirements).[207] In effect, the entire section 522(f) exercise would turn out to be pointless.[208] If the object of subsection (f)(3) was to prevent avoidance of meaningful economic liens granted in a nonconsumer, business setting, but still preserve the value of the exemption up to $5,000, subsection (f)(3) has failed to accomplish that aim. It has failed because it neglects to factor into the analysis liens that do not fall under section 522 at all, or in the case of personal property, the fact that appreciation is rarely in the cards.

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206. Recognizing these problems, the National Bankruptcy Review Commission, as part of its broader call for a single across-the-board valuation standard, has called for use of wholesale price in determining the value of a secured creditor's interest in personal property, and fair market value less hypothetical sale costs, in determining the value of a creditor's secured claim in real estate. *See* NATIONAL BANKRUPTCY REVIEW COMMISSION, *supra* note 22, at 243-58, 511-26. In the context of section 522 and its policy of ensuring the debtor of a minimum fresh start, there is sound justification for using an even lower forced sale standard. *See infra* text accompanying note 281.

207. *See* U.C.C. § 9-507(2) (1995) (codifying the rule that the fact that a better price might have been received under other circumstances does not alone make a sale commercially unreasonable); *see also* NATIONAL BANKRUPTCY REVIEW COMMISSION, *supra* note 22, at 519 n.1290 (collecting authorities documenting that most UCC foreclosures generate relatively little interest and notoriously low prices).

208. Similar problems exist with respect to the value of exempt property generally, although the trustee's sale under the aegis of the bankruptcy court is vastly superior to state law foreclosure as a mechanism for assuring that the sale of the property will yield a fair price. *See generally* Lynn LoPucki, *A General Theory of the Dynamics of the State Remedies/Bankruptcy System*, 1982 WIS. L. REV. 311, 320-21 & n.52 (contrasting sale procedures under state law and in bankruptcy).

III. SECTION 522(f)(3) IN THE COURTS

There are, as of this writing, five reported court decisions that undertake to analyze section 522(f)(3) in any detail. An examination of each of these decisions reveals that the language in subsection (f)(3) is too convoluted, and too out of sync with the letter and spirit of the rest of section 522(f) for any semblance of consistent and rational interpretation.

A. *In re* Zimmel

In the first reported decision to construe subsection 522(f)(3), *In re Zimmel*,[209] the bankruptcy court held that subsection (f)(3) was inapplicable under Minnesota's exemption scheme. The debtors, husband and wife, sought to avoid liens on $26,000 of farm machinery based on Minnesota's $13,000 per-debtor exemption for farm equipment used by a debtor primarily engaged in farming activities. The defendant-creditors responded that the debtors' avoidance rights were each limited to $5,000 based on the special restriction in subsection (f)(3).[210] In analyzing that defense, the court observed that neither prong of subparagraph (A) of section 522(f)(3) made particular practical or linguistic sense. However, the court accepted the creditors' view that the first prong, regarding "voluntary waiver of the right to claim exemptions under section 522(d)," must refer to the circumstance where, as in Minnesota, the law does not prohibit the use of the federal bankruptcy exemptions,[211] but the debtor nonetheless elects to have her exemptions determined under state law. So construed, the alternative tests in subparagraph (A) simply set forth a threshold requirement that the limitation in subsection (f)(3) only pertains when state exemptions control in the case, either because the debtor has elected or, in opt-out

209. 185 B.R. 786 (Bankr. D. Minn. 1995).

210. *See id.* at 790; *see also* Howard, *supra* note 18, at 281 (stating that section 522(f)(3) "permits the debtor to avoid a lien on specified types of property . . . only up to $5,000 in value"). As discussed earlier, it is unlikely that the limitation in subsection (f)(3) was intended to be applied in this fashion.

211. *Zimmel*, 185 B.R. at 791 (noting that neither of the creditors in the case was able to explain why such a simple application would be expressed in such a convoluted fashion).

states, was required to claim her state exemptions instead of the exemptions in section 522(d).[212]

With respect to subparagraph (B) of section 522(f)(3), the creditors in *Zimmel* conceded the nonapplicability of the first prong—that the state law allow exemptions in unlimited amounts—since Minnesota's farm equipment exemption was limited by a maximum dollar sum.[213] However, they argued that the second prong was applicable because Minnesota, like most states, recognizes the principle that exemptions are subordinate or subject to consensual security interests in the property.[214] In exposing the fallacy of this argument, the court, after relating the history leading to the enactment of section 522(f)(3),[215] noted that a prohibition on lien avoidance is something entirely different from a rule that excepts encumbered property from otherwise allowable exemptions.[216] Thus, because neither of the alternatives in subparagraph (B) applied, the court concluded that the liens against the debtors' property could be avoided under section 522(f)(1)(B) to the full extent that they impaired the exemption as calculated under section 522(f)(2).

B. In re Parrish

In *In re Parrish*,[217] the bankruptcy court refused to make the distinction that accounted for the result in *Zimmel* between a prohibition on lien avoidance and a rule recognizing that exemptions are not applicable to consensual liens. The debtor, a farmer, exempted two tractors as "tools of the trade" for $7,500,

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212. 11 U.S.C. § 522(d) (1994).

213. *See id.* The court stated that the reason that the first prong was not met was that "Minnesota does not allow exemptions in an unlimited amount." *Id.* at 791. It is unclear how the court might have ruled if, for example, Minnesota had an unlimited homestead exemption, even though a dollar limitation was imposed on the statutory exemption for farm equipment. *See supra* text accompanying note 191.

214. *See Zimmel*, 185 B.R. at 791-92.

215. *See id.* at 793-95 (observing that subsection (f)(3) was the result of special interest efforts aimed at overruling *Owen v. Owen*, 500 U.S. 305 (1991), in no exemption limit opt-out states such as Florida and Louisiana, and high exemption non-opt-out jurisdictions such as Texas).

216. *See Zimmel*, 185 B.R. at 792-93 (relying on *Moyer v. International State Bank*, 404 N.W.2d 274 (Minn. 1987), and noting that while Minnesota law recognizes that exemptions do not apply to consensual liens, the law is silent regarding *avoidance* of consensual liens on property otherwise eligible to be claimed as exempt property).

217. 186 B.R. 246 (Bankr. W.D. Wis. 1995).

the maximum amount permitted under Wisconsin law, and then sought to avoid a bank's nonpurchase-money security interest against the property. Wisconsin, like Minnesota, has a statute prohibiting assertion of a claim of exemption against the holder of a security interest in the property.[218] The court determined that the existence of this statute, "despite its opacity and its confusing disjunctions," satisfied the second prong of section 522(f)(3)(B) as effectively prohibiting the avoidance of consensual liens.[219] Accordingly, the court held that section 522(f)(3) applied and, thus, the bank's lien could only be avoided "up to $5,000."[220]

The conclusion that a statute subordinating an exemption claim to consensual liens is equivalent to a statutory prohibition against avoidance of consensual liens is open to serious question. However, even having once decided that section 522(f)(3) applied to the transaction, the court's implementation of the statute was even more dubious. Specifically, the court read the $5,000 limitation as applying not to the value of the exempt property, as the language of the statute seems to imply, but rather to the amount of the lien susceptible to avoidance. Although not entirely clear, this meant that the bank's lien could be reduced by no more than $5,000. This interpretation would seem to belie both the letter and the spirit of the statute as demonstrated when hypothetical values are attached to the property and the lien.[221]

Assume the tractors were together valued at $10,000 and the bank's lien against the tractors secured an indebtedness of $15,000. By virtue of the formula in section 522(f)(2) the lien would be deemed to impair to the extent of $12,500,[222] and thus would be reduced to $2,500. This would permit the debtor to enjoy the full value of the $7,500 Wisconsin exemption, consistent with the original policy of section 522(f)(1). Under the reasoning of *Parrish*, however, $10,000 of the lien would survive,[223] which

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218. *See id.* at 247 (citing WIS. STAT. § 815.18(12) (1994)).

219. *Id.* at 248.

220. *See id.*

221. *See supra* notes 198-99 and accompanying text.

222. The calculation would be: ($15,000 + $7,500) = $22,500 - $10,000 = $12,500.

223. *See Parrish*, 186 B.R. at 248 (holding that section 522(f)(3) "limits the amount that may be avoided in 'tools of the trade' to $5,000"). The effect of this determination in the actual case is not known because the brief decision does not indicate either the value of the property or the amount of the liens sought to be avoided.

would leave the tractors fully encumbered and deprive the debtor of any exemption, except in the unlikely event of subsequent appreciation.[224] Alternatively, if the values were reversed so that the lien was oversecured by $5,000 (tractors worth $15,000, lien secures an indebtedness of $10,000), the lien would be deemed to impair under section 522(f)(2) to the extent of only $2,500, again resulting in the debtor being permitted to enjoy the full amount of the exemption.[225] Oddly, in this scenario, since actual impairment is under $5,000, the approach adopted in *Parrish* would produce the same result and the limitation in subsection (f)(3) would not apply. If, however, as suggested earlier,[226] the properly understood object of subsection (f)(3) is to insure that the debtor emerges from bankruptcy with no more than $5,000 in exemptible property of the kind described in that provision, then the formula suggested in *Parrish* overcompensates the debtor in the second scenario,[227] just as it undercompensates the debtor in the first scenario.

Regardless of whether it is appropriate to limit the extent of lien avoidance powers against Tools of the Trade Collateral in the first place, such a restriction should at least produce consistent results unaffected by the fortuitous relationship between the value of the collateral and the amount secured by the lien. Therefore, as discussed in greater detail below,[228] a principled approach to the $5,000 limitation in section 522(f)(3) would, in the first scenario with an undersecured creditor, permit avoidance of the lien to the extent of $10,000, the portion that is not *not* avoidable, leaving the debtor with $5,000 of equity in her tools of the trade.[229] Similarly, in the second scenario with an

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224. *See supra* note 206 and accompanying text.

225. The calculation would be: ($7,500 + $5,000) = $12,500 - $10,000 = $2,500.

226. *See supra* text accompanying notes 193-94.

227. This occurs because the debtor enjoys the full $7,500. Under the interpretation of section 522(f)(3) suggested above as most rational, calculating the limitation (or amount not avoidable) derived under subsection (f)(3) by deducting $5,000 from the value of the property, would lead to the conclusion that the lien is not avoidable to the extent of $5,000. *See supra* note 200 and accompanying text. Since this amount is greater than the amount of impairment calculated under subsection (f)(2), the effect would be to eliminate the debtor's right to avoid any portion of the lien, resulting in a $5,000 exemption.

228. *See infra* Part IV.

229. The lien is not avoidable to the extent that the value of the property ($10,000) exceeds $5,000. One interpretation means that the balance of the lien survives. The other equally plausible construction of section 522(f)(3) is that the $5,000 amount is subtracted from the amount of impairment, in this case meaning

oversecured creditor, the debtor could not avoid the fixing of a lien to the extent the value of the tractors ($15,000) exceeded $5,000, which is to say that the entire $10,000 lien would survive.[230]

C. *In re* Ehlen

In re Ehlen,[231] the only case thus far to produce a decision on appeal, is a decision emanating from the same district as *Parrish*, although authored by a different judge. In *Ehlen*, the joint debtors each claimed a $7,500 exemption for farm implements, and then sought to avoid the nonpossessory, nonpurchase-money security interest of the Farm Service Agency ("FSA") against that property. The FSA responded by invoking *Parrish* to support the position that section 522(f)(3) operates by imposing a $5,000 federally mandated cap on the debtor's lien avoidance powers. Relying on the reasoning in *Zimmel*, the court rejected the argument, noting that the reference to a state provision that "prohibits avoidance of a consensual lien on property 'refers to a remedy that allows the stripping of liens in various situations' and is distinguishable from a mere exemption claim."[232] By contrast, the court observed that the Wisconsin statute simply precludes a debtor from claiming an exemption for property subject to consensual liens.[233] In addition, the court pointed out that the broader reading urged by the FSA would amount to an overruling of *Owen v. Owen*,[234] in direct contravention of the legislative history to subsection (f)(3) that suggested the provision was intended only as a narrow reversal of *Owen* in states like Louisiana, which permit unlimited exemptions for tools of the trade but excepts property subject to a validly granted lien, and in states like Texas, which limit generous personal property

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the lien is not avoidable to the extent of $7,500 and the debtor has only a $2,500 exemption in her tools of the trade. This is preferable to the result produced under the *Parrish* holding, *see* 186 B.R. 246, but it holds the potential to eliminate any equity at all if, for example, the exemption amount were $5,000 or less.

230. *See supra* note 223.

231. 202 B.R. 742 (Bankr. W.D. Wis. 1996), *aff'd sub nom.* United States v. Ehlen, 207 B.R. 179 (W.D. Wis. 1997).

232. *Id.* at 747 (quoting *In re* Zimmel, 185 B.R. 786, 792 (Bankr. D. Minn. 1995)).

233. *See id.* at 749-50 (distinguishing section 815.18(12) of the Wisconsin Statutes from section 42.002(b) of the Texas Property Code).

234. 500 U.S. 305 (1991).

exemptions with provisions that not only exclude personal property subject to a security interest, but expressly provide that the security interest may not be avoided on the ground that the property is exempt.[235] Lastly, the court noted that the expansive interpretation advanced by the FSA would, if adopted, unreasonably interfere with the clear legislative policy of the Bankruptcy Code to promote future financial stability through the fresh start.[236]

On appeal, the district court concurred with the bankruptcy court's reasoning as to when section 522(f)(3) applies, and therefore affirmed the holding below that the FSA's lien could be avoided to the full extent of the Wisconsin farm implements exemption.[237] However, albeit in dictum, the district court also appears to have approved the *Parrish* view as to the effect of subsection (f)(3) in circumstances where one of the alternative conditions in both subparagraphs (A) and (B) are satisfied, namely, to cap the debtor's lien avoidance rights at $5,000.[238]

D. In re Duvall

In the most recent and certainly the most complete treatment of the issue, the bankruptcy court in *In re Duvall*[239] adopted the narrow reading of section 522(f)(3) advanced in *Zimmel* and *Ehlen*, but rejected the *Parrish* explanation of how the limitation in that provision operates when the conditions necessary to trigger its application are satisfied. Significantly, *Duvall* is the first case decided by a court in one of the states, Texas, whose exemption laws were the target of the lobbyists who shepherded section 522(f)(3) through Congress.[240]

The debtors in *Duvall* claimed a tools of the trade exemption under Texas law for property valued in their schedules at $55,287. The property was, however, subject to a lien in favor of the FSA securing an indebtedness of $167,289.84. Therefore, the

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235. *See Ehlen*, 202 B.R. at 747-49.

236. *See id.* at 750.

237. *See* United States v. Ehlen, 207 B.R. 179 (W.D. Wis. 1997), *aff'g* 202 B.R. 742 (Bankr. W.D. Wis. 1996).

238. *See id.* at 182. ("The basic idea of these rather clumsy paragraphs is that if the applicable state law fits one or the other of the two alternative conditions in both paragraphs, the debtor's lien avoidance is capped at $5,000 . . . .").

239. 218 B.R. 1008 (Bankr. W.D. Tex. 1998).

240. *See supra* note 161 and accompanying text.

debtors filed a motion to avoid the FSA's security interest under section 522(f)(1)(B), noting that under the statutory formula in section 522(f)(2) the entire lien impaired their exemptions.[241] The FSA, in turn, argued that section 522(f)(3) was applicable to these facts and that under its provisions the debtors could only avoid the portion of the lien in excess of the difference between the value of the property and $5,000. That difference ($50,287), if subtracted from the amount of the lien, would have left an unavoided encumbrance of $117,000, more than twice the value of the property. Obviously, the FSA easily could have sustained that loss without sacrificing any decrease in the value of its actual secured claim.

The court began its analysis with sections 522(f)(1) and (f)(2), concluding that the FSA's lien was a qualifying lien impaired to the extent of $167,289.84 and, therefore, before considering the impact of subsection (f)(3), could be avoided in full.[242] Turning next to subsection (f)(3), the court agreed with *Ehlen* that to read subparagraph (A) so that the first prong is satisfied where state law permits the debtor to select between state and federal exemptions would render the phrase meaningless because the two prongs together would encompass every state.[243] Thus, the court accepted the lesser of two "absurdities" and adopted the *Zimmel* construction of the statute[244] that subparagraph (A) is satisfied whenever a debtor uses state exemptions either by election or compulsion in opt-out jurisdictions.[245]

With respect to subparagraph (B), the court found that the second prong was satisfied by section 42.002(b) of the Texas

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241. *See Duvall*, 218 B.R. at 1013. This was based on the amount by which the lien and the exemption exceeded the value of the property, ($167,289.84 + $55,287) - $55,287. *See id.*

242. *See id.* at 1013-16. Central to the court's analysis was its determination that the "to the extent" language in sections 522(f)(1) and (2) constituted words of limitation meaning "by the amount that" rather than "if." *See id.* at 1016; *supra* note 193.

243. *See Duvall*, 218 B.R. at 1017 (citing United States v. Ehlen, 207 B.R. 179, 182 (W.D. Wis. 1997)).

244. *See supra* note 211 and accompanying text.

245. See *Duvall*, 218 B.R. at 1019, where the court states:

> Faced with the choice between a contractual-waiver interpretation that never applies because no state makes (or attempts to make) contractual waivers enforceable, and a procedural-waiver interpretation which—although awkwardly worded—ensures that § 522(f)(3)(A) is satisfied whenever a debtor utilizes state exemptions (voluntarily in a non-'opt out' state or involuntarily in an 'opt out' state) the Court chooses the latter.

Property Code, which, unlike its counterparts in Minnesota and Wisconsin, does indeed prohibit avoidance of consensual liens against exempt property.[246] Turning its attention then to implementation of the $5,000 limitation in subsection (f)(3), the court rejected both the view that the qualifying lien may not be avoided at all if the property is worth more than $5,000,[247] and the *Parrish* view construing subsection (f)(3) as imposing a $5,000 limitation on the amount of the avoidance.[248]

Instead, the court suggested that the analysis of the $5,000 limit must begin with a determination of the portion of the offending lien that is otherwise avoidable under sections 522(f)(1) and (f)(2), and only then move to a determination of the amount that is made nonavoidable by virtue of subsection (f)(3).[249] In this connection, the court concluded that this limitation "is measured by the difference between the value of the exempt property and $5,000."[250] On the facts of the case, this calculation produced a $50,287 limitation on the debtors' lien avoidance power: the difference between the value of the debtors' tools of the trade ($55,287) and $5,000. This reduced the FSA's lien against the property by $117,002.84, from $167,289.84 to $50,287, with the result (presumably intended by Congress) that the debtors would emerge from bankruptcy with $5,000 of equity in their tools of the trade.[251] The court observed, however, that although this interpretation of section 522(f)(3) produced a reasonable result in this case, there is no guarantee that it would obtain the same result under other facts.[252]

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246. *See id.* at 1019; *see also supra* note 160.

247. *See Duvall*, 218 B.R. at 1019-21 (emphasizing again that this interpretation improperly entailed reading the phrase "to the extent" to mean "if," instead of as words of limitation).

248. *See id.* at 1022 (noting that subsection (f)(3) is a limitation on the amount of avoidance, but that the limitation is not $5,000).

249. *See id.* at 1012 (rejecting the FSA's argument that section 522(f)(3), not (f)(1), controlled the disposition of the dispute).

250. *Id.* at 1022 (citing David G. Carlson, *Security Interests on Exempt Property After the 1994 Amendments to the Bankruptcy Code*, 4 AM. BANKR. L.J. 57, 67 (1996)).

251. *See Duvall*, 218 B.R. at 1022. The court noted that, in a joint case, such as this one, the limitation would be $10,000. *See id.* Thus, it is unclear why in its application of subsection (f)(3) the court subtracted only $5,000 from the value of the property.

252. *See id.* at 1022 (citing Carlson, *supra* note 86, at 80). For example, if the applicable tools of the trade exemption in Duvall had been $20,000, the FSA's security interest would have impaired the exemption only to the extent of $132,002.44 (($167,289.84 + $20,000) - $55,287). The portion of the lien not

Finally, the court noted that for purposes of the calculation contemplated in subsection (f)(3), all of the debtor's tools of the trade must be aggregated.[253] This raises the issue discussed earlier of how the $5,000 in value is to be allocated among multiple items of exempt property.[254] Unlike the exemptions in section 522(d)[255] that single out individual items of property that the debtor may designate, one of the several shortcomings in section 522(f)(3) is that it does not permit the debtor to decide which of her tools of the trade are most important to her fresh start.

Although the court in *Duvall* does not address this latter issue, the decision is commendable for making the most sense so far out of the convoluted jumble of subsection (f)(3). Still, the court had to indulge certain assumptions concerning congressional intent behind the senseless statutory language in order to produce anything even approaching a clearheaded application of this provision. Moreover, as the *Duvall* court itself observed, its interpretation would not produce reasonable results in other circumstances.[256] In short, no matter how diligently a court proceeds in attempting to construct a principled and rational interpretation, the reality is that the statutory language imposes constraints too stifling to be overcome. Thus, the only

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avoidable under subsection (f)(3) would still be $50,287, which, under the *Duvall* court's approach, would be deducted from the $132,002.84 figure, leaving $81,715.84 as not avoidable and, concomitantly, $85,574.84 as avoidable. The effect, of course, would be to deprive the debtors of any exemption. This result, although concededly justified under the specific language of subsection (f)(3), *see Duvall*, 218 B.R. at 1021 n.8, belies the legislative history to that provision which defines the new provision as a "limited exception to the debtor's ability to avoid nonpossessory, nonpurchase-money security interests in implements, professional books, or tools of the trade of the debtor." *Id.* (citing 1994 HOUSE REPORT, *supra* note 135, at 56). It also is directly contradictory with the basic thrust of the 1994 amendments to section 522 which were aimed at assuring that creditors not be permitted to retain liens after bankruptcy that might have the effect of depriving the debtor of an exemption in the property. *See id.* Therefore, the alternative way to read the statute under such circumstances is that the negative implication of the conclusion that the lien is not avoidable to the extent of $50,287 is that it *is* avoidable above that amount. *See supra* note 200. A similar problem potentially exists where the property at issue is subject to a nonavoidable prior security interest since the formula under subsection (f)(3), unlike subsection (f)(2), does not take such liens into account in determining the value of the exempt property. *See supra* text accompanying notes 200-01.

253. *See Duvall*, 218 B.R. at 1023.

254. *See supra* note 201 and accompanying text.

255. 11 U.S.C. § 522(d) (1994).

256. *See supra* note 252 and accompanying text.

sensible alternative is to redraft subsection (f)(3), both to overcome its poor draftsmanship (doubtless a product of special interest influence accounting for its inclusion in the first place) and to narrowly tailor its operation in a manner that is consonant with both its legitimate policy aims and section 522(f) as a whole.[257]

IV. UNSCRAMBLING THE EGGS: AN ALTERNATIVE ANALYSIS AND A PROPOSAL FOR REFORM

In its present incarnation, section 522(f)(3) is nothing short of disaster. It was crudely drafted to begin with, has been inconsistently applied as a consequence, and threatens to be the agent of further mischief in the future. This erodes public and professional confidence in the integrity of the consumer bankruptcy system, and promotes the sort of unhealthy cynicism that frequently breeds more bad laws. Lamentably, however, as long as federal bankruptcy law continues to permit some measure of state control over exemption policy, there remains, as noted earlier, a legitimate justification for at least something like section 522(f)(3).[258] Unquestionably, the ideal solution would be to eliminate the need for such a provision entirely by adopting a single, mandatory list of uniform federal bankruptcy exemptions.[259] Failing that solution, courts need some direction in attempting to develop a prudential set of guidelines for applying subsection (f)(3) as currently drafted, and the legislature needs to consider a more objective and discriminating version of the provision than the one that was foisted on us by an unwary Congress in 1994.

A. A Principled Interpretation of Section 522(f)(3)

Obviously, an expansive interpretation of subsection (f)(3) is detrimental to the fresh start principle in personal bankruptcy cases. Therefore, consistent with the attitude taken by the courts in construing other provisions in the Bankruptcy Code that

257. *See infra* notes 282-313.

258. *See infra* notes 285-89.

259. See Lawrence Ponoroff, *Exemption Limitations: A Tale of Two Solutions*, 71 AM. BANKR. L.J. 221 (1997); *see also infra* text accompanying note 310.

impinge upon the fresh start policy,[260] it should be strictly construed. This suggests, as a preliminary matter, that the burden of establishing the requirements of subsection (f)(3) should be placed on the creditor seeking to limit the debtor's avoiding powers.[261] It also dictates that the inherently ambiguous terms of subsection (f)(3) should be resolved in a manner that coincides with bankruptcy law's intrinsic bias in favor of promoting the fresh start for honest debtors. An interpretation guided by these principles produces the following conclusions.

1. Subparagraph (A)

Subparagraph (A) should only be regarded as satisfied if the debtor's state of residence has affirmatively opted-out of the federal exemptions as contemplated by section 522(b)(2),[262] or if the objecting creditor produces evidence to show that the state, by positive statute or clear rule from a state appellate court, expressly permits its debtors to waive their federal exemptions. The fact that it is unlikely the creditor would ever meet that burden in a non-opt-out jurisdiction is neither here nor there.[263] If non-opt-out states intend to take advantage of this limited ability to opt-out of a portion of section 522(f)'s lien avoidance provision, the statute as currently drafted requires them to acknowledge openly that fact by passing conforming legislation, not dissimilar from the manner in which Texas anticipated this

260. *See, e.g.*, Bellco First Fed. Credit Union v. Kaspar (*In re* Kaspar), 125 B.R. 1358, 1361 (10th Cir. 1997) (citing Schweig v. Hunter (*In re* Hunter), 780 F.2d 1577, 1579 (11th Cir. 1986) and noting that "exceptions to discharge are to be narrowly construed, and, because of fresh start objectives of bankruptcy, all doubts are to be resolved in debtor's favor").

261. This is consistent with the notion that subsection (f)(3) operates essentially as an affirmative defense once the debtor has established entitlement to avoid the security interest under subsection (f)(1)(B). A similar pattern can be found in the provisions governing preferential transfers. See Code section 547(g), 11 U.S.C. § 547(g) (1994), which places the burden on the trustee to establish the elements of a preferential transfer under Code section 547(b), 11 U.S.C. § 547(b) (1994), and the burden on the creditor of proving the non-avoidability of the transfer under one of the defenses in Code section 547(c), 11 U.S.C. § 547(c) (1994).

262. 11 U.S.C. § 522(b)(2) (1994).

263. *See In re* Zimmel, 185 B.R. 786, 791 (Bankr. D. Minn. 1995) (pointing out that "it is unlikely that any state law permits its persons to waive the right to claim exemptions under 11 U.S.C. § 522(e), since waivers of exemptions are specifically unenforceable under 11 U.S.C. § 522(e)").

legislation when it enacted its "no lien avoidance" law.[264] Courts like *Duvall* that insist on a "plain meaning" approach in construing one part of section 522(f)(3), such as the $5,000 limitation, should not deviate from this principle in construing subparagraph (A), which is equally as straightforward, simply because Congress failed to express itself in a logical or coherent fashion.[265] Alternatively, if the courts are to accept the argument that Congress could not have meant what it said in this context, then they should also be willing to indulge a purposive explanation of how to apply the $5,000 limitation.[266]

2. Subparagraph (B)

Employing a plain language method of interpretation, one would certainly be justified in insisting that all of a state's exemptions must be available without limitation before the first prong of subparagraph (B) of section 522(f)(3) is satisfied. However, given the absence of any reasonable or logical relationship between other exemptions and the exempt collateral that forms the focus of subsection (f)(2), such a literalistic reading is probably not warranted under any theory of statutory construction.[267] On the other hand, it would not be unreasonable or illogical to require that each of the categories of exempt property forming the subject matter of subsection (f)(3)—professional and trade-related, and farm-related collateral[268]—be

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264. *See supra* note 161.

265. In *In re Duvall*, 218 B.R. 1008, 1021-22 n.8 (Bankr. W.D. Tex. 1998), the court indicated that it was bound to a plain meaning interpretation of the $5,000 limitation even though, in some instances it might produce a nonexistent exemption. At the same time, however, the court refused to construe subparagraph (A) as requiring an express waiver, even though that is what the language unequivocally requires, because it would produce an absurd result. *See id.* at 1019. In fairness, the *Duvall* court hardly found subparagraph (A) to be plain and clear, describing it as "a textual riddle wrapped in mysterious legislative history inside an enigma of conflicting interpretations." *Id.* at 1018-19.

266. *See supra* notes 193-94.

267. Equally implausible is the view that subsection (B)(3) is satisfied if the state's catalogue of exemptions includes any exemption that is not subject to a dollar limitation. *See supra* note 191.

268. In the increasing number of states that take the more modern approach of defining personal property exemptions in lump sum, rather than categorized terms, this condition would never be satisfied. In states that continue to define exemptions by particular property types, it is necessary to equate the specified types of property in subsection (f)(3) with the state-defined property interests.

exempt without monetary limitation under applicable state law.

By the same token, as three of the four decisions to address the issue have agreed, the second criteria in subparagraph (B) should be read to require something more than a governing state law recognizing that the debtor may, by agreement, subordinate the exempt property to the priority created by a voluntary security interest.[269] Instead, this test should be satisfied only when the state has accepted (as the Texas legislature did in a preemptive fashion) the implicit invitation to adopt affirmatively legislation addressing the issue of lien avoidance.[270]

3. What to Do with $5,000?

Most problematic is the question of the proper meaning to give the language restricting subsection (f)(3)'s lien avoidance limitation in circumstances where the value of the property exceeds $5,000. Although the other constituents of section 522(f) focus on the dollar value of the liens and exemptions, this provision is concerned with the value of the property. Thus, applications that either limit the avoidability of the lien to $5,000,[271] or make the portion of the lien exceeding $5,000 nonavoidable, misapprehend the method that Congress chose, advisedly or ill-advisedly, for ensuring that the debtor could retain some professional items and farm property free from nonpossessory, nonpurchase-money security interests.[272] That is to say, in calculating the amount of the impairing lien that is not *not* avoidable under subsection (f)(3), both the amounts of the lien and the exemption limitation are irrelevant, despite the fact that both items are directly relevant to the threshold determination of the extent to which a lien impairs an exemption under section 522(f)(2). Instead, a court facing the daunting task of applying this provision must subtract $5,000 from the fair market value of

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269. *See supra* text accompanying notes 215-16. *But see In re* Parrish, 186 B.R. 246, 248 (Bankr. W.D. Wis. 1995).

270. *See In re* Ehlen, 202 B.R. 742 (Bankr. W.D. Wis. 1996). There is no reason to treat this requirement with less formality than, for example, the provision in section 522(b), 11 U.S.C. § 522(b) (1994), requiring states that do not wish to permit their debtors to elect the section 522(d), 11 U.S.C. § 522(d) (1994), exemptions to enact specific opt-out legislation.

271. *See* United States v. Ehlen, 207 B.R. 179 (W.D. Wis. 1997), *aff'g* 202 B.R. 742 (Bankr. W.D. Wis. 1996); *see also Parrish,* 186 B.R. at 246.

272. *See supra* notes 198-99 and accompanying text.

the property. The difference then represents the maximum amount in which an otherwise avoidable lien should be permitted to survive bankruptcy.[273]

However, because this calculation ignores other nonavoidable liens, it does not effectively implement the goal of leaving the debtor with some subsection (f)(3) property that the debtor can use to return to economic viability.[274] The omission is particularly glaring and ironic in that it occurred at the same time that Congress finally resolved the question of when a lien impairs, and did so in a manner that fully recognized the effect of other non-section-522(f) liens.[275] The harmful effects of neglecting to address the same problem in the context of subsection (f)(3) are ameliorated to some extent by the fact that it is far less likely than it is in the case of real estate collateral that the kinds of personal property enumerated in section 522(f)(3) will be the subject of multiple liens. Nevertheless, if the concept of subsection (f)(3) is to assure that debtors, although not able to avoid large liens against expensive items of nonconsumer collateral, still emerge from bankruptcy with a minimum level of exempt tools of the trade, then unavoidable liens should be factored into the analysis to protect the debtor's equity, at least up to the $5,000 ceiling.[276]

In addition, in the case of a lien that only partially impairs, it requires reading the provision as an absolute limitation on the portion of the lien that may remain after bankruptcy rather than as a deduction from the voidable portion of the lien.[277] This is the circumstance which the *Duvall* court referred to in explaining why, under its interpretation of the $5,000 limitation, there will be circumstances where section 522(f)(3) does not produce a reasonable result.[278] Although necessary to rationalize section

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273. Under this interpretation, the $5,000 represents a "cap" on the maximum allowable exemption to which the debtor is entitled in bankruptcy with respect to the types of property described in subsection (f)(3). The more difficult question is whether it also constitutes a "floor" in circumstances where either the applicable state exemption is *less* than $5,000, *see infra* note 302, or where the debtor's state law exemption is limited in amount and, under the section 522(f)(2) formula, the qualifying lien only partially impairs, *see supra* note 201.

274. *See supra* note 193 and accompanying text.

275. *See supra* note 134.

276. *See* Everett, *supra* note 132, at 1352 n.129 (discussing the same point in terms of ensuring that the debtor receives a postbankruptcy "surplus" of $5,000).

277. *See supra* note 201.

278. *See supra* note 252 and accompanying text (discussing examples where

522(f) as a whole, this construction is admittedly a difficult one.[279] Finally, although subsection (f)(3) was intended to prevent the debtor from avoiding significant consensual liens,[280] use of a fair market standard of value may, in certain circumstances, end up as a practical matter depriving the debtor of any meaningful exemption.[281] For all of these reasons, the only truly satisfactory solution to the quandary requires nothing less than a complete legislative revision of section 522(f)(3).

B. A Legislative Proposal

The legislative history of the Bankruptcy Reform Act of 1978 indicates that section 522(f) was enacted in response to what were perceived as unconscionable creditor practices in the consumer credit industry.[282] In particular, Congress evinced concern about creditors obtaining blanket security interests in the debtor's otherwise exempt personal property, not because of the intrinsic economic value of the collateral if the creditor were actually forced to foreclose, but because of the leverage value of the security interest. Specifically, the combination of the personal nature of the property, its high replacement cost for the debtor, and the emotional impact of being forced to imagine the property being forcibly removed in front of the defaulting debtor's friends, neighbors, and children, provided creditors holding such a security interest with a powerful tool to obtain preferred treatment on the debt in bankruptcy.[283] At the same time, given low resale proceeds, both as an absolute matter and in relation to repossession and foreclosure costs, creditors generally did not regard this collateral itself as a meaningful source of payment that they could turn to in the event of the debtor's default.[284]

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section 522(f)(3)'s limitation on avoidance leaves the debtor with no net equity over and above the sum of all liens).

279. *See supra* note 252.

280. *See supra* text accompanying note 168.

281. *See supra* notes 207-08.

282. *See generally* 1978 HOUSE REPORT, *supra* note 128, at 127, *discussed in In re* Sweeney, 7 B.R. 814 (Bankr. E.D. Wis. 1980).

283. *See supra* note 32. The same collection of concerns accounted for the Code's stringent restrictions on the enforceability of reaffirmation agreements. *See* 11 U.S.C. § 524(c)-(d) (1994).

284. *See generally* BARKLEY CLARK, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE ¶ 12.04[4] (rev. ed. 1993).

In light of this rationale, particularly after *Owen* precluded states from eliminating property subject to valid liens from the definition of exempt property,[285] a convincing case could and was made that some limitation needed to be placed on the ability of debtors to avoid consensual liens on nonconsumer collateral, such as Tools of the Trade Collateral, which might involve very valuable items of personalty.[286] In fact, the Federal Trade Commission rule prohibiting nonpurchase-money security interests in certain consumer collateral,[287] itself derived from section 522(f), is limited to "household goods" and personal effects of the "consumer and his or her dependents,"[288] and expressly excludes from the definition household goods works of art, antiques, jewelry, electronic equipment, and other items likely to have considerable market value.[289]

Although the case can thus be made for including some limitation on the debtor's ability to avoid consensual liens on Tools of the Trade Collateral, it is important not to lose sight of the fact that an equally good case based on the Code's fresh start policy can be made against inclusion of such a rule. To begin with, while section 522(f)(1)(B)'s reference to "implements, professional books, or tools of the trade" incorporates property used by an individual proprietor in a small business, the line

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285. *See supra* text accompanying note 83.

286. *See supra* note 127 (referring to the testimony of Phillip S. Corwin before the House Subcommittee on Economic and Commercial Law). Although the credit industry's motivation in placing some brake on debtors' section 522(f)(1)(B) avoiding powers was likely more self-interested than "restoring the unencumbered flow of agricultural and small business credit," *Bankruptcy Reform: Hearing Before the Subcomm. on Economic and Commercial Law of the House Comm. on the Judiciary*, *supra* note 127, at 219, indeed the potential for debtors to take advantage of section 522(f)(1)(B) by using its provisions to set aside true reliance liens on large, expensive items of personal property did exist. However, the problem was not so much a bankruptcy problem as it was a state law problem created by unusually generous tools of the trade exemptions. Ironically, the credit industry resisted early proposals urging that the new Code adopt mandatory federal bankruptcy exemptions. *See* Ponoroff & Knippenberg, *supra* note 4, at 253.

287. *See supra* note 32.

288. FTC Credit Practices Rule, 16 C.F.R. § 444.1(i) (1998).

289. *See id. See generally supra* note 22. Section 122 of House Bill 3150, *see supra* note 22, proposes to add a definition of "household goods" for bankruptcy purposes consistent with the meaning set forth in 16 C.F.R. § 444.1(i), which, of course, would incorporate the exclusion for consumer goods likely to have substantial value. The intent, presumably, is to limit the debtor's avoiding power under section 522(f)(1)(B)(i), although it is not clear that this result would follow when the debtor's exemptions are claimed under state law containing a more expansive definition of "household goods." *Cf. supra* note 33.

between personal and business bankruptcy is a blurry one, especially in the case of sole proprietors.[290] In fact, the need for a fresh start is often no less compelling for small-business owners than for wage earners, although only the latter easily fits the paradigm of "consumer bankrupt," an undefined, imprecise category which nevertheless forms the basis for distinction in several points in the Bankruptcy Code.[291] Furthermore, the limitations in the Federal Trade Commission rule are not directly or analogically apposite because, unlike section 522(f), that rule is designed to curb overreaching creditor conduct, not to afford the debtor with a financial fresh start.

Finally, even conceding for the sake of argument that there is a legitimate concern that Tools of Trade Collateral could include property with substantial value in which a creditor has a true reliance interest, the same simply cannot be said for farm collateral. The reference to "crops" and "animals" in subsection 522(f)(1)(B) is limited by the traditional indicia of consumer property, namely, that which is "held primarily for personal, family, or household use of the debtor." Thus, short of the argument that it is impossible to disassociate the farmer in his personal and business capacities, there is no reason to warrant a limitation on the debtor's avoiding power with respect to this type of collateral. Moreover, even if the argument concerning the inherent ambiguity in classifying a farm debtor's bankruptcy as a business or commercial case is valid, it is a double-edged sword since the difficulty in economically and culturally differentiating between a consumer and a small-business debtor is what weakens the case for a Tools of the Trade Collateral limitation as well.

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290. *See supra* note 19.

291. For instance, the "substantial abuse" provision in Code section 707(b), 11 U.S.C. § 707(b) (1994), applies only in chapter 7 cases filed by an individual debtor whose debts are primarily consumer debts. The term "consumer debt" is defined in 11 U.S.C. § 101(8) (1994) as a "debt incurred by an individual primarily for a personal, family or household purpose." 11 U.S.C. §101(8) (1994). However, the meaning of that language is not free from doubt. *Compare* Interstate Securities Corp. v. Costantino (*In re* Costantino), 72 B.R. 189, 192 (Bankr. D.S.C. 1986) (holding that a debt incurred in order to purchase investment securities did not qualify as a "consumer debt" for "luxury goods or services" for purposes of the presumption of nondischargeability in section 523(a)(2)(C), 11 U.S.C. § 523(a)(2)(C) (1994)), *with* Trump Plaza Assocs. v. Poskanzer (*In re* Poskanzer), 143 B.R. 991, 1000 (Bankr. D.N.J. 1992) (concluding that a debt incurred to permit the debtor to engage in gambling activities did constitute a "consumer debt" for "luxury goods or services" within the meaning of section 523(a)(2)(C)).

In any event, if the political consensus demands some form of limitation on the holding in *Owen*, the current section 522(f)(3) is not an acceptable response, even when interpreted consistently with the suggestions offered above. The only acceptable solution is a legislative one that responds to the interpretational shortcomings in the current version of the statute, eliminates the unnecessary inclusion of farm-related collateral distinct from tools of the trade, and corrects the present failure to address the complexities introduced when the collateral is subject to multiple liens. Such a revision might read as follows:

> (f)(3)(A) In a case where the debtor elects not to claim exemptions under subsection (d), or is prohibited by State law from making such an election, and State law either (1) imposes no monetary limitation on the right to claim exemptions in implements, professional books, and tools of the trade of the debtor or a dependent of the debtor; or (2) prohibits by separate statute the avoidance of a consensual lien on any such property; the debtor may avoid the fixing of a lien otherwise avoidable under subparagraph (f)(1)(B) only to the extent the amount of such lien exceeds the difference between the value of such property and the sum of (1) all liens against such property (excluding any avoidable liens); and (2) the lesser of $5,000[292] or the maximum ex-emption allowed.[293]

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292. The stated dollar amount over and above the sum of all other liens to be shielded from the limitation in revised subsection (3) should be added to the items subject to review and adjustment under section 104(b), 11 U.S.C. § 104(b) (1994), every three years based on changes in the national CPI. *See supra* note 193. Under the new formulation, this number represents the minimum dollar value of Tools of the Trade Collateral that the debtor will emerge from bankruptcy with unencumbered by nonpossessory, nonpurchase-money liens. Indeed, the failure to include a reference to section 522(f)(3) in section 104(b) in the first place appears to have been an oversight. Of course, where the applicable state exemption level is *less* than $5,000, the adjustment would not be required.

293. Certainly, favorable justification exists for simply leaving the amount at $5,000 regardless of the level of the state exemption. The effect of that proposal would be to make $5,000 a "floor" in states with tools of the trade (or comparable) exemptions of less than $5,000, as well as a "ceiling" in states with higher limitations, which would be similar to the approach adopted by the National Bankruptcy Review Commission with respect to the homestead exemption. *See* NATIONAL BANKRUPTCY REVIEW COMMISSION, *supra* note 22, at 125-33 (proposing use of state homestead exemption levels, subject to a federally imposed maximum of $100,000 and minimum of $20,000). Nevertheless, the final limitation has been left in the alternative for purposes of this proposal since it is intended to capture the spirit and apparent legislative intent that accounted for the addition of section 522(f)(3) to the Code and not to deviate from that original intent in a way that is either pro-debtor or pro-creditor.

> (B) In any case where this subsection operates to limit the debtor's power to avoid any portion of a lien otherwise avoidable under subsection (f)(1)(B), the debtor may designate individual items of property that shall be deemed free and clear of such lien, provided that the value of the remaining property subject to the lien, over and above all prior liens if any, is at least equal to the value of the lien remaining in effect after application of the provisions of subparagraph (A) hereof.
>
> (C) For purposes of determining the value of the debtor's property under subparagraph (A), the court shall consider the value likely to be received upon a forced sale of such property.[294]

There are several points to be made about this new rendering of the statute. First, because inclusion of farm-related collateral under the restriction in subsection (f)(3) serves no practical purpose in its present form, the collateral made subject to the limitation under the proposed rule excludes crops and farm animals.[295] Second, the debtor is permitted to designate the particular items of property to which she wishes to have her $5,000[296] of equity allocated. This reduces the probability that the purposive object of the statute will be undermined by the secured creditor's sale of essential tools of the trade that cannot be replaced for $5,000. Third, by adding all unavoidable liens to the amount that is subtracted from the amount of the lien, the debtor is assured of exiting bankruptcy with $5,000 in unencumbered tools of the trade, as long as such equity exists above the amount of all nonavoidable liens. Fourth, the use of forced sale value ensures that the basic policy objectives of section 522(f) are not lost sight of in this effort to constrain the occasional claim for

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294. The legislative history would have to be made clear that no inferences are to be drawn from the express use of forced sale value in this context with respect to valuation issues arising elsewhere under the Code. *See supra* note 205.

295. This omission also eliminates what Professor Carlson has referred to as the "harmless piece of nonsense" created by the fact that current subsection (f)(3) affects not only the debtor's avoiding power with respect to her own property, but that of her dependent's property as well, even though there is no ability under section 522(f)(1)(B)(i) to set aside a security interest in crops owned, as opposed to used, by a dependent of the debtor. *See* Carlson, *supra* note 86, at 76.

296. Under revised section 522(f)(3), the figure is less than $5,000 in cases where the applicable state law exemption is also under $5,000. *See supra* note 293. However, in the interests of clarity, this point will not be reiterated for the remainder of this discussion.

avoidance of liens against unusually expensive items of personalty with high exemptions limits. Fifth, because the calculation of the limitation is structured so that the $5,000 is added to the sum of all liens against the exempt property before deducting that total from the value of the property, the proposal limits the tools of the trade exemption in bankruptcy to $5,000, regardless of how much of the qualifying lien must be avoided to achieve that result.[297] At the same time, it assures that the extent of the debtor's avoiding power will not be limited arbitrarily and that the debtor will have a certain minimum value of lien-free property.[298]

The following examples illustrate the operation of the new provision in a variety of the scenarios, many of which were considered earlier. In each case assume that the property is an item of personal property that qualifies as a tool of the debtor's trade under applicable state law:

297. This rejects the approach taken in *In re* Parrish, 186 B.R. 246 (Bankr. W.D. Wis. 1995).

298. Simultaneously, the revised version of the statute also eliminates what Professor Carlson describes as the "cruel" result that may pertain when subsection (f)(3) is applied to cases where the debtor's exemption is stated in limited dollar terms. *See* Carlson, *supra* note 86.

Value of Property	Exemption Amount	Amount of § 522(f)(1)(B) Lien	Amount of Non-avoidable Liens	Impairment Under § 522(f)(2)	Amount Avoidable After Application of Revised § 522(f)(3)	Exemption Amount Enjoyed by Debtor
$7,000	$5,000	$10,000	$0	$8,000[299]	$8,000[300]	$5,000
$50,000	$2,400	$100,000	$0	$52,400	$52,400[301]	$2,400[302]
$50,000	$2,400	$100,000	$20,000	$72,400	$72,400[303]	$2,400
$50,000	Unlimited	$100,000	$0	$100,000	$55,000[304]	$5,000
$50,000	Unlimited	$100,000	$20,000	$100,000	$75,000[305]	$5,000
$10,000	$7,500	15,000	$0	$12,500	$10,000[306]	$5,000
$10,000	$7,500	$5,000	$0	$2,500	$0[307]	$5,000

299. The calculation is the sum of the lien ($10,000) and the exemption amount ($5,000), less the value of the property ($7,000) = $8,000.

300. No limitation is placed on the debtor's avoiding power since, under the first step in the analysis, the debtor's exemption does not exceed $5,000. The calculation under revised section 522(f)(3) of the amount by which the impairing lien can be avoided is as follows: amount of the lien ($10,000) minus the difference between the value of the property ($7,000) and (there being no other liens) the exemption amount ($5,000). $10,000 - $2,000 = $8,000, as the maximum extent to which the qualifying lien can be avoided.

301. *See* Carlson, *supra* note 86. This is the example given by Professor Carlson. Under revised subsection (f)(3) there is no longer any ambiguity as to whether the debtor will emerge from bankruptcy with the amount of the exemption. The calculation is: $100,000 - ($50,000 - $2,400) = $47,600.

302. The debtor enjoys an exemption of only $2,400 because the state law limit is less than $5,000. As noted, there is some argument for making the $5,000 a floor as well as a ceiling in such a case. *See supra* note 273.

303. With the introduction of an unavoidable lien, the calculation is as follows: the amount of the lien ($100,000) minus the difference between the value of the property ($50,000) and the sum of the nonavoidable lien ($20,000) plus the allowed exemption ($2,400) = $27,600. $100,000 - $27,600 = $72,400.

304. As intended, revised subsection (f)(3) limits the debtor's ability to avoid the impairing lien to prevent the debtor from enjoying an unreasonably large exemption in the specified property. The calculation is as follows: $100,000 - ($50,000 - $5,000) = $55,000 is avoidable; $45,000 is not.

305. Because the $20,000 nonavoidable lien (perhaps a purchase-money security interest) is added to the exemption amount and then subtracted from the value of the collateral, the lien is avoidable in an amount $20,000 greater than in the scenario immediately above. This is the issue that is not addressed at all under current subsection (f)(3). *See supra* note 275 and accompanying text.

306. This scenario is the first hypothetical posed above following discussion of the *Parrish* case. *See supra* note 222 and accompanying text. As explained at that point, the most logical construction of subsection (f)(3) in its present form is that the debtor would enjoy only a $2,500 exemption, seemingly in contravention of congressional intent.

307. $5,000 - ($10,000 - $5,000) = $0. Under this scenario, revised subsection (f)(3) precludes any portion of the lien from being set aside. This eliminates the problem of "overcompensating" the debtor. *See supra* text accompanying note 227.

These examples demonstrate that this revised approach is both more principled and more workable than the current formulation of section 522(f)(3); for example, in any case involving multiple liens, such as the chart's third scenario, it assures the debtor a lien-free exemption in tools of the trade equal to the lesser of $5,000 or the maximum applicable state exemption amount.[308] At the same time, however, it is readily admitted that these hypotheticals also show that the revised approach is, at best, only marginally less convoluted. That is to say, producing the desired result still involves a series of mathematical steps, creating the potential for mistakes at any stage in the process.

Lamentably, this is the unfortunate but inevitable byproduct of any system that relies, in whole or in part, on the vagaries of state law to define exemption limitations. Thus, although some limitation on the ability to exempt Tools of the Trade Collateral is arguably appropriate where state law controls and provides either an unlimited exemption or inadequate limits taking into account the existence of the bankruptcy discharge,[309] this concern could be addressed most effectively by the adoption of mandatory uniform federal exemptions in bankruptcy.[310]

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308. This was the weakness in the current statute addressed by the court in *Duvall*. *See supra* note 252 and accompanying text.

309. Under state law, a debtor can also use an exemption to shield assets from the clutches of creditors. However, if at any point, the exempt asset is converted back to nonexempt form, creditors can seize the debtor's property to satisfy their claim. In a bankruptcy context the discharge ups the ante since the debtor need only maintain the asset in exempt form until the discharge is granted. *See* Ponoroff & Knippenberg, *supra* note 4, at 247 n.9.

310. *See* Ponoroff, *supra* note 259, at 239 (pointing out that an ancillary benefit flowing from adoption of mandatory uniform federal exemptions in bankruptcy would be elimination of the need for section 522(f)(3)). In fact, with the exception of the homestead exemption, the National Bankruptcy Review Commission has urged adoption of uniform lump sum exemption amount. *See* NATIONAL BANKRUPTCY REVIEW COMMISSION, *supra* note 22, at 133-38.

The case could also be made that any form of federally imposed limitation on the enforceability of state exemption levels in bankruptcy is unwarranted in light of the initial decision to defer to state law with respect to setting exemption limits as a matter of public policy. Still, it is irresponsible to set ceilings on state exemption levels without also setting floors. *See supra* note 302. If it is appropriate to cap certain exemptions because the states that set those levels do so without taking into account the prejudicial effect of the discharge on creditors, it is no less true that those levels are also arrived at without consideration of the fresh start aims of the bankruptcy system, resulting in some instances in unreasonably low exemption amounts that frustrate fresh start policy. *See* Brown, *supra* note 21, at 180 ("The federal government's default to the states has encouraged regional favoritism. State by state variations in the exemptions affect not only the debtor's fresh start but also

Thus far, however, Congress has evinced no particular enthusiasm for mandating federal bankruptcy exemptions.[311] Therefore, without in any way wishing to dampen whatever ardor does exist in favor of moving in that direction, it is appropriate to consider reforms of existing law that would make reliance on state exemptions in bankruptcy more rational and fair, such as the proposal detailed above to implement a more restrictive rendering of section 522(f)(3). An equally good case might also be made that because, as originally drafted and enacted, subsection (f)(3) was a brazen effort by the credit industry, which has generally opposed mandatory federal bankruptcy exemptions,[312] to have its cake and eat it too,[313] rationality and fairness dictate that perhaps section 522(f)(3) should simply be repealed. In other words, if, as a matter of policy, state exemption dollar limits control, they control for better or worse. Nevertheless, this proposal seeks to take cognizance of reasonable creditor concerns, but limits the application of section 522(f)(3) to cases where unconditional dependence on state law produces results at variance with the ultimate goals in consumer bankruptcy cases of fairly balancing the debtor's right to a financial fresh start with creditors' legitimate expectations of payment.

CONCLUSION

The 1994 Amendments took one step forward by cogently defining the meaning of impairment in section 522(f)(2), and another step back by saddling us with the ill-conceived and nearly incomprehensible language of section 522(f)(3). Indeed, there is

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distributions to creditors, creditor dissatisfaction with excessive exemptions, forum shopping by debtors, and public dismay at apparent inequities.").

311. Section 320 of Senate Bill 1301, the Consumer Bankruptcy Reform Act of 1997, *see supra* note 22, would cap the combined homestead and burial plot exemption that could be claimed under state law at $100,000, but otherwise not change the current opt-out arrangement in section 522(b), 11 U.S.C. § 522(b) (1994). Section 7(b) of House Bill 3146, The Consumer Lenders and Borrowers Bankruptcy Accountability Act of 1998, in an effort to ensure greater fairness in the bankruptcy system, proposed to establish the existing section 522(d), 11 U.S.C. § 522(d) (1994), exemptions as a uniform national minimum. *See* H.R. 3146, 105th Cong. §7 (1998). However, it continued to allow the states to set higher exemption levels. Section 7(a) of that bill would have capped the homestead at $100,000 with respect to property acquired within one year of filing with property converted to take advantage of an unlimited state homestead exemption. *See id.*

312. *See supra* note 165.

313. *See supra* note 166.

no good way to harmonize the two provisions; subsection (f)(2) was adopted to solve specific problems that had developed in the case law while subsection (f)(3), in its present form, is an unintelligible and dreadfully confusing piece of special interest legislation resulting from the efforts of self-interested credit industry lobbyists. This does not mean that the groups urging these changes were acting out of spiteful malice or without some substantive concern over a real problem. It does mean, however, that since it is the role of the legislative body to separate the wheat from the chafe, by enacting section 522(f)(3) in its present form, Congress clearly abdicated its responsibility. Therefore, without conceding in any way the possibility that there are better solutions to the problems of exemption policy in bankruptcy, the legislative approach offered above is aimed at denuding the current statute of its unbalanced, unintelligible, and one-sided constituents in order to achieve a legitimate accommodation between state law exemption schema and federal bankruptcy policy.

Even if this proposal were to become widely endorsed, other problems persist. The issue of the permissible scope of exemptions available in bankruptcy, just like the question of the proper scope of the bankruptcy discharge, are highly charged political questions to which there are no easy and obvious answers. Consumer bankruptcy legislation wobbles back and forth between more debtor protections and greater creditor rights without any obvious or fixed normative fulcrum. The problem, of course, is the lack of general agreement on first principles and the absence of any consistent moral or economic view of what we want our credit culture to look like. The likelihood that we will reach that kind of consensus any time in the near future is dim indeed, as recent events have amply shown.[314] In the meantime, however, we need to be vigilant that the individual pieces of bankruptcy reform legislation that are enacted are at least coherent, objectively fair, and efficient. Section 522(f)(3) fails that test miserably, and it is in the hopes of rectifying that one failure that this proposal is put forth, not only as a specific fix, but also as a preliminary step toward a more balanced and reasoned global reform of consumer bankruptcy law in the United States.

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314. *See supra* note 22 and accompanying text.