

SECURITY INTERESTS ON EXEMPT PROPERTY

AFTER THE 1994 AMENDMENTS TO THE

BANKRUPTCY CODE

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The Bankruptcy Code FN1 permits debtors to avoid certain security interests on certain categories of exempt property. Such an innovation extends the concept of exempt property from its traditional domain, which placed exempt property beyond the reach of judgment creditors. Historically, it was always thought that the debtor could *give* away exempt property. Hence, there was nothing traditionally wrong with the debtor's consent to a security interest on this property. Such a security interest could be enforced like any other.

Starting the 1970s, however, consumer advocates discovered that nonpurchase— money, nonpossessory security interests in consumer goods were pernicious. The Federal Trade Commission declared them to be an unfair trade practice by secured creditors. FN2 In conjunction with this declaration, Congress enacted section 522(f)(1) of the Bankruptcy Code to permit avoidance of these security interests when they encumber certain "core" exempt property. FN3 The theory behind this avoidance is that debtors may too easily have signed adhesion contracts with secured creditors, blanketing all their consumer goods with liens. FN4 These consumer goods had no intrinsic value on the market, but the security interest gave secured creditors an unfair coercive power over debtors who could not or would not pay back their loans. FN5

Section 522(f) FN6 was like a great many provisions of the Bankruptcy Code as it was first enacted; it was very prodebtor and hence, at least on an anecdotal level, capable of spectacular abuse. Debtors could avoid very large security interests on very expensive items by proving the items were "tools of the trade" within the meaning of section 522(f)(1)(B)(ii). FN7 Thus, in *Rainier Equipment Finance, Inc. v. Taylor (In re Taylor)*, FN8 to give one example, the debtor was able to show that a \$52,000 logging truck was a tool of the trade and, of course, the nonpurchase—money security interest on it had to go. **FN9**

Creditors learned to hate this avoidance power and commenced a long campaign to undercut it. FN10 Their first initiative was by means of state law. FN11 If state law allowed exemption of the debtor's equity in a thing (as opposed to the thing—in—itself), then secured creditors could justly argue that the security interest did not "impair" the exemption, as section 522(f)(1)(B) avoidance requires. FN12 Since only the debtor equity was exempt, the security interest could eliminate the exemption simply by assuring that no debtor equity existed. FN13

Such a state—law theory was obliterated by the Supreme Court in *Owen v. Owen*, FN14 where the Court implied that security interests on exempt property could be destroyed regardless of the content of state exemption law. **FN15** After *Owen*, secured creditors needed federal intervention to prevent what they took to be debtor abuses of the section 522(f)(1)(B) avoidance power. Accordingly, Congress, in 1994, added two new subsections to section 522(f). FN16 One subsection, contrary to the general *esprit* of the 1994 amendments, is actually prodebtor. FN17 New section 522(f)(2) defines "impairment" of an exemption in a way that reverses some procreeitor case law on what impairment means. FN18 This new definition conforms to the definition assumed in *Owen v. Owen*. FN19

The second subsection is rigorously procreeitor. The new section 522(f)(3) repeals avoidances otherwise available under section 522(f)(1)(B). FN20 It does so only when the collateral is, in its unencumbered state, worth more than \$5000. FN21 But this defense against avoidance surely counts as one of the most densely confusing pieces of legislation ever enacted this side of the Internal Revenue Code.

The purpose of this Article is to work out a theory of what these new provisions mean. FN22 As the new amendments react primarily to *Owen v. Owen*, Part I discusses that case in detail, in order to show its relevance to secured creditors claiming exempt property as collateral. It also shows how newly enacted section 522(f)(3) partially reverses *Owen*, but only after testing the quality of state exemption legislation. As we shall see, the test is very confusing indeed. To date, it has been revealed that Minnesota is free and clear of reform. FN23 Whether other states will also join

Minnesota's secessionary instinct depends on how courts read the deeply confusing conditions precedent in section 522(f)(3).

Part II explores the new definition of "impairment" that Congress has added. If section 522(f)(3) is baffling, the new definition of impairment is not; it is straightforward and sensible not to mention very prodebtor. Part III uses this definition of impairment to illustrate how the new defense against lien avoidance works. As we shall see, the defense has some very surprising features all of them very procreditor and many of them highly arbitrary. Under certain circumstances, debtors will find that their section 522(f)(1) avoidance power will have no effect; rather, the nonpurchase-money security interests on their exempt property will be entirely upheld against the avoidance that section 522(f)(1)(B) describes.

I. OWEN V. OWEN

According to section 522(f)(1): "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." [FN24](#) If state legislation exempts only debtor equity in collateral, it arguably follows that the security interest is not subject to section 522(f)(1) avoidance. [FN25](#) In such a case, the security interest does not "impair an exemption" within the meaning of section 522(f)(1). [FN26](#) And if the security interest does not encumber exempt property, then section 522(f)(1) cannot perform its oblitative function on the security interest at all. [FN27](#)

Initially, some courts so ruled, and as a result, when a state exemption law was felicitously worded, secured parties could preserve their nonpurchase-money security interests. [FN28](#) In *Owen v. Owen*, [FN29](#) however, the Supreme Court implied that security interests on exempt property can be destroyed regardless of the content of state exemption law. [FN30](#) *Owen* concerned a judicial lien on exempt property, [FN31](#) something covered by section 522(f)(1)(A) and not section 522(f)(1)(B). [FN32](#) Nevertheless, the Court's reasoning is fully applicable to both provisions. [FN33](#)

In *Owen*, an ex-wife had already obtained a judgment against her ex-husband when the latter bought a condominium apartment. [FN34](#) The judicial lien attached to the condo upon acquisition, pursuant to standard after-acquired property assumptions. [FN35](#) The next year, Florida allowed condos to be exempt property, but it preserved any pre-existing judicial liens. [FN36](#) Therefore, under state law the ex-wife had a valid judicial lien, even though the condo was itself exempt from all future judgment liens. [FN37](#)

Section 522(f)(1)(A) authorizes avoidance of judicial liens "to the extent that such lien impairs an exemption to which the debtor *would have been entitled* under subsection (b)" of section 522. [FN38](#) The debtor reasoned that, because of the emphasized subjunctive language, section 522(f)(1)(A) permitted the avoidance of the judicial lien on the exempt property. [FN39](#) The ex-wife was of the view that the judicial lien did not impair the exemption, within the meaning of section 522(f), and so the lien should stand. [FN40](#)

Justice Antonin Scalia ruled that the judicial lien could be avoided. "To determine the application of [section] 522(f)," [FN41](#) Scalia wrote, courts interpreting the federal exemption must "ask not whether the lien impairs an exemption to which the debtor is in fact entitled, but whether it impairs an exemption to which he *would have been* entitled but for the lien itself." [FN42](#) This principle, applied to the Florida exemption, implies that the debtor gets, not the exemptions to which she *is* entitled, but to what she *would* have been entitled if the lien did not exist. [FN43](#) Thus, section 522(f)(1) destroyed the Florida judicial lien, and once again an ex-husband was allowed to escape the family obligations that both positive and natural law demand. [FN44](#)

This reasoning directly affects Article 9 security interests under section 522(f)(1)(B). [FN45](#) Hence, *Owen* briefly settled that, whatever the content of local state exemption law, section 522(f)(1)(B) is competent to destroy any otherwise valid security interest on the specific exempt items listed in section 522(f)(1)(B). [FN46](#) Through the subjunctive reasoning invoked by Justice Scalia, which emphasized what "would have been" exempt but for the security interest, state legislation could not whittle down the avoidance power in section 522(f)(1)(B). [FN47](#)

In order to reverse the most extreme implications of *Owen*, Congress, in 1994, added a confusing new subsection to section 522(f). New section 522(f)(3) reads as follows:

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) 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;

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 \$5000. FN48

This section is supposed to repeal *Owen* with regard to big ticket "tools of the trade" that might be exempt, but not to the smaller, more modest items. **FN49** *Owen* continues to apply when the collateral is worth less than \$5000. FN50

The effect of section 522(f)(3) is to roll back the avoidance accomplished in section 522(f)(1)(B). FN51 Before observing how this defensive rollback of avoidance works, it is necessary to acquire a firm grasp of Congress's new definition of "impairment" under section 522(f)(2).

II. IMPAIRMENT

If a nonpossessory, nonpurchase–money security interest encumbers a qualified household good or tool of the trade, it does not follow that the debtor may avoid the entire security interest. FN52 Rather, section 522(f)(1)(B) avoids nonpurchase–money security interests only "to the extent that such lien impairs an exemption." FN53 If the entire thing is exempt, then the very existence of the security interest always impairs the exemption. But when the debtor may only exempt a certain dollar amount of the collateral, lien avoidance might be partial only. FN54 This makes it necessary to calculate the amount of the lien avoidance.

In 1994, Congress, responding to pell–mell havoc and confusion in the case law, FN55 defined impairment in new section 522(f)(2):

(A) For the 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 liens on the property;

exceeds the value that the debtor's interest in the property would have in the absence of any liens. FN56

To illustrate the nature of the required calculation, suppose that a car is deemed a "tool of the trade" within the meaning of section 522(f)(1)(B)(ii), thereby entitling the debtor to some avoidance of a nonpurchase–money security interest on this "tool." FN57 If only one avoidable lien exists on the motor vehicle, this dollar limit poses no complexity. For instance, suppose a bankruptcy trustee sells a motor vehicle for \$2650, and A has a nonpurchase–money security interest on the motor vehicle for \$600. Section 522(f)(1)(B) avoids a nonpurchase–money security interest only to the extent "such lien impairs an exemption," FN58 per the above definition. According to that definition, impairment and hence avoidance is calculated by adding the targeted lien (\$600), all other liens (\$0), and the debtor's exemption (\$2400 if the federal car exemption FN59 applies). FN60 From this sum (\$3000) we subtract the unencumbered value of the debtor's interest (\$2650). FN61 Avoidance therefore equals \$350; the secured party obtains the amount of the lien minus the avoidance (\$600 – 350 = \$250). FN62 The debtor takes the rest (\$2400), which of course, equates with the amount of the exemption. FN63

This formula replicates the philosophy of *Owen v. Owen*.^{FN64} That is, according to Justice Scalia's suggestion, we are to imagine what the debtor could have exempted if there were no security interests at all.^{FN65} Only after we imagine away the security interests do we test whether or not they impair the debtor's exemption.^{FN66}

One unanswered question, however, is whether, after the lien avoidance occurs and the trustee abandons the collateral, the secured party's claim is capable of growing through the accrual of interest and attorneys' fees called for by the security agreement. The answer ought to be that, since the \$350 represents a cap on the secured claim, the secured claim is presumably not capable of growing beyond this amount.

Even though the claim's upside growth is frozen, the secured creditor takes the risk of depreciation over time.^{FN67} Because the debtor has a permanent right to recover \$2400 out of the exempt property in the above example, the secured party takes all the risk that the collateral will depreciate over time. ^{FN68} In essence, the debtor is the senior lien creditor and A is a junior lien creditor suffering from a cap on her lien. On fortune's cap, she is not the very button.^{FN69}

Suppose now that two security interests encumber the motor vehicle one belonging to A, who is senior, and the other belonging to B, who is junior. A claims \$600 and B claims \$4000. Suppose both of these security interests are avoidable, because the motor vehicle is a "tool" under section 522(f)(1)(B)(ii) and these are nonpurchase-money security interests.^{FN70} The value of the car is still \$2650.

Applying the definition literally, we must calculate *twice*, because there are two nonpurchase-money security interests on the collateral. Although section 522(f)(2) does not say so, it is very important that the most junior lien first be subjected to calculative scrutiny. Last in right is first in calculation. Otherwise, the senior lien will be avoided and the junior lien will survive.

Accordingly, with regard to the \$4000 junior lien, we add the amount of that lien (\$4000), the amount of all other liens (\$600),^{FN71} and the amount of the exemption (\$2400).^{FN72} From this sum (\$7000), we subtract the value of the car (\$2650), for a total of \$4350. This constitutes the amount of avoidance to which the debtor is entitled.^{FN73} Therefore, the \$4000 junior lien is entirely avoided.

We now move on to the senior lien. According to section 522(f)(2)(B): "In the case of a property subject to more than [one] lien, a lien that has been avoided shall not be considered in making the calculation under subparagraph (A) with respect to other liens." ^{FN74} As we have avoided the \$4000 lien, it is no longer relevant. The initial sum we need is now the amount of the senior lien (\$600), all other liens (\$0, by virtue of section 522(b)(2)(B)), and the exemption (\$2400).^{FN75} From this sum (\$3000), we subtract the value of the car (\$2650) to obtain \$350.^{FN76} Therefore, the senior lien obtains \$250 (\$600 minus \$350). The debtor obtains the exempt amount of \$2400.^{FN77} Both these security interests impair the exemption, one partially and the other entirely. Therefore, the junior security interest is entirely avoided and the senior security interest is partially avoided. This outcome does require the sensible restriction that one assess the most junior security interest before proceeding to those that are more senior.^{FN78}

An alternative mode of calculation under section 522(f)(2) is possible. The alternative calculation would exploit the premise that a "lien" can never be for an amount in excess of the collateral.^{FN79} To illustrate how this might work, imagine that A claims \$600, B claims \$4000, the exemption is for \$2400, and the unencumbered value of the collateral is \$3100. Because A's lien is for \$600, B's lien, as we are now redefining it, is for \$2500, not \$4000. Per this definition, and applying the formula of section 522(f)(2)(A), we take the sum of B's targeted lien (\$2500), A's valid lien (\$600), and the exemption (\$2400); and from this sum (\$5500), we subtract the unencumbered value of the collateral (\$3100).^{FN80} The result is avoidance of \$2400, leaving B with a lien of \$100.^{FN81} Given A's valid lien for \$600, the debtor has an exemption worth \$2400. This is precisely the result we would have reached if we defined B's lien by the amount of the total debt outstanding (\$4000). Hence, it makes no difference whether "lien" is tied to the value of B's collateral or to the amount of B's total claim.^{FN82}

A. Underwater Liens

Suppose the senior unavoidable security interests eat up all the value of exempt property, and yet there are still some junior security interests that are themselves avoidable. Can section 522(f) be used to get rid of these liens, which are entirely under water? [FN83](#) The answer is yes. Such unwanted barnacles may be scoured from the exempt property, thanks to the formula now provided in section 522(f)(2). [FN84](#)

For example, suppose *A* and *B* each claims \$1000, and each also claims the debtor's automobile as collateral. The debtor has convinced the court that the automobile is a "tool" within the meaning of section 522(f)(1)(B)(ii). [FN85](#) The automobile has an appraised value of \$2650. *A*'s security interest is purchase money and hence not voidable under section 522(f)(1)(B). [FN86](#) *B*'s security interest is voidable under section 522(f) provided the court thinks that security interests entirely under water impair exemptions. [FN87](#)

Applying the formula in section 522(f)(2), [FN88](#) we start with *B*'s junior lien. Although nothing in section 522(f)(2) requires this point of departure, [FN89](#) we saw earlier that any other point of departure produces the absurd result of preserving the junior lien and avoiding the senior lien. [FN90](#) In light of this assumption, we take the sum of the most junior lien (\$1000), all other liens (\$1000), [FN91](#) and the amount of the exemption (\$2400). [FN92](#) From this sum (\$4400), we subtract the value of the collateral (\$2650). [FN93](#) The result (\$1750) represents the amount of avoidance. [FN94](#) Hence, *B*'s lien is entirely avoided.

As to *A*'s lien, we take the sum of the lien (\$1000), other valid liens (\$0), [FN95](#) and the exemption (\$2400). [FN96](#) From this sum (\$3400), [FN97](#) subtract the value of the car (\$2650) to find the extent of avoidance (\$750). [FN98](#) This reduces *A*'s lien from \$1000 to \$250, so that *A* obtains \$250 and the debtor takes her exemption of \$2400. [FN99](#)

In these calculations, the underwater portion of *B*'s lien was eliminated. Prior to 1994, many courts took the position that section 522(f) could not apply to the underwater portion of a lien. [FN100](#) Presumably these cases are no longer viable because, under the calculations demanded by section 522(f)(2), the amount of avoidance is always sufficient to avoid the entire underwater portion of any lien. [FN101](#)

B. Marshaling of Assets

The subordination of a valid security interest to one that is voidable under section 522(f)(1)(B) gives rise to a difficult marshaling puzzle that arose, but was not addressed, in *In re Zimmer*. [FN102](#) In *Zimmer*, a purchase money lender subordinated its security interest to that of a large nonpurchase-money agricultural lender. [FN103](#) The debtor was entitled to avoid at least part of this senior nonpurchase-money security interest, [FN104](#) but not the subordinated purchase money security interest. [FN105](#) In principle, it should be possible for the debtor to avoid the security interest on the exempt property and preserve it for her own benefit, at the expense of the subordinated purchase money lender who is entirely under water. [FN106](#)

For example, suppose the debtor owns two items of collateral one exempt and one not, and both worth \$100. The exempt item is purchase money collateral for *B*, who, as in *Zimmer*, has subordinated her purchase money security interest to the voidable security interest of *A*, who claims \$100. [FN107](#) *A* could therefore take the nonexempt item, allowing *B* to take the purchase money collateral. Or the debtor could insist that *A*'s security interest encumbers both items, permitting the debtor to avoid the security interest on the exempt item and forcing *A* to pursue the nonexempt item. The debtor could then assert the avoided security interest on the purchase money collateral against *B*'s valid security interest.

Is it fair for the debtor to use a voidable security interest that *A* does not even need to prevent *B* from getting at her collateral? The answer is yes, because *B* has, either contractually or by failing to perfect under state law, staked out a junior position as to the exempt item. The debtor's avoidance theory fully honors that junior position. Furthermore, *B* has no valid marshaling claim to direct *A* toward the nonexempt collateral. [FN108](#) Marshaling is, in general, a doctrine for the benefit of junior lien creditors. [FN109](#) It is appropriately used when a senior creditor claims two items of collateral, as in the above example, and where the junior creditor claims only one. [FN110](#) In such a case, the junior creditor can insist that the senior creditor first exhaust the singly encumbered collateral before returning to the doubly encumbered collateral. [FN111](#) It is a rule of marshaling, though, that *B* cannot insist on marshaling when yet another junior creditor claims the other collateral. [FN112](#) In such a case, *two* junior creditors each have a marshaling claim

against the senior creditor. **FN113** The two claims cancel each other out, and neither can insist that *A* choose one or the other of the doubly encumbered items. FN114

Since the bankruptcy trustee is a hypothetical judicial lien creditor as of the day of the bankruptcy petition, FN115 the trustee is just as entitled to marshaling as *B* is. Therefore, neither can direct *A* toward any item of collateral. Hence, even before the debtor enters the picture, *B* is disentitled to marshal in the above example. FN116 *A* is free, then, to take whichever item of collateral it wants, without any interference from either *B* or the trustee. FN117

Meanwhile, *A*'s lien is voidable by the debtor as to the exempt property. FN118 As always, "voidable" is a misnomer in the Bankruptcy Code. It is avoided—but—preserved. FN119 In other words, *A*'s lien is transferred over to the debtor, for the debtor's benefit in preserving the exemption. FN120 Now, if *A* has complete freedom to assert her lien against the exempt property, free from any objection by *B* or the trustee, and if the debtor is now the owner of *A*'s lien, then the debtor has this freedom as well. **FN121** Therefore, the debtor should be able to rescue the exempt item from the purchase money security interest of *B*. FN122

In contrast, at least one case implies that the debtor has no right to marshal when a single secured creditor claims an exempt item as purchase money collateral and a nonexempt item as nonpurchase—money collateral. FN123 The debtor cannot marshal against the purchase money security interest, and the bankruptcy trustee cannot marshal against the nonpurchase—money security interest. In this situation, the inability of either "junior lien creditor" **FN124** to marshal at the expense of the other is canceled. The debtor cannot argue that she has the rights of a senior lien creditor. Rather, the debtor is junior and is therefore subject to the rule that it cannot marshal at the expense of another junior lien creditor. In such a case, the secured party may choose either item of collateral without any interference from the bankruptcy trustee.

C. Circular Priorities

When a debtor can only exempt property up to a specific dollar amount, FN125 difficult circular priorities may arise. FN126 Returning to the example of the automobile, which is federally exempt to the amount of \$2400, FN127 suppose that *A*'s security interest is voidable under section 522(f)(1)(B) but *B*'s is not. FN128 For example, suppose that *B* subordinated her purchase money security interest to the voidable nonpurchase—money security interest of *A*. FN129 Or suppose that *B* forgot to perfect her purchase money security interest, while *A* has perfected its nonpurchase—money security interest. *A*'s security interest is therefore senior, while the trustee has either not avoided *B*'s unperfected security interest or avoided but preserved it for the benefit of the general creditors. FN130 These circumstances imply a circular priority. FN131 The debtor's exemption is senior to *A* (to the extent *A* impairs the exemption); *A* is senior to *B*; and *B* is senior to the debtor's exemption. FN132 Indeed, where the debtor claims an exemption limited in dollar amount, it would appear that the debtor has as much of a lien on the exempt item as *A* or *B*. FN133

Under the new definition of impairment, *A*'s \$600 security interest is entirely void. Applying the formula to *A*'s lien, we add the amount of that lien (\$600), the amount of all other liens (\$4000), and the amount of the exemption (\$2400). FN134 From this sum (\$7000), we subtract the value of the car (\$2650), for a total of \$4350. FN135 This constitutes the amount of avoidance to which the debtor is entitled more than enough to kill off *A*'s entire \$600 lien. Furthermore, this distribution to the debtor out of *A*'s share (before *B* receives anything) is required by section 522(i), which provides:

(1) If the debtor avoids a transfer or recovers a setoff under subsection (f) or (h) of this section, the debtor may recover in the manner prescribed by, and subject the limitations of, section 550 of this title, the same as if the trustee had avoided such transfer, and may exempt any property so recovered under subsection (b) of this section.

(2) Notwithstanding section 551 of this title, a transfer avoided under section 544, 545, 547, 548, 549, or 724(a) of this title, under subsection (f) or (h) of this section, or property recovered under section 553 of this title, may be preserved for the benefit of the debtor to the extent that the debtor may exempt such property under subsection (g) of this section or paragraph (1) of this subsection. FN136

This provision states that any lien avoided under section 522(f) is preserved for the debtor's benefit, to the extent that the debtor may avoid the lien under section 522(g) or section 522(i)(1). FN137 Hence, A's security interest is transferred over to the debtor, who may assert its priority against that of B's purchase money security interest. FN138

Prior to 1994, courts had to figure out for themselves what constituted impairment in a circular priority case. FN139 Three solutions had been devised. The "expansive" approach awarded all of A's lien to the debtor. FN140 This is the prodebtor approach Congress adopted in 1994 when enacting section 522(f)(2). FN141 It calculates impairment of the debtor's exemption in a very ahistoric way as calculated at the time of the bankruptcy petition. FN142 The expansive approach admittedly encourages a debtor to give junior security interests on property solely for the purpose of squeezing out senior lien creditors. FN143

The so-called "chronological" FN144 approach split the difference and partly validated A's senior lien, but only to the extent the lien did not impair an exemption at the time it was created. FN145 In the above example, A's lien for \$250 would be valid. The draconian "waiver" approach denied all recovery to the debtor on the theory that the sum of all consensual security interests indicated that the debtor had waived all right to exempt the property from creditors. FN146

III. THE SECTION 522(f)(3) LIMIT

Nonpurchase-money, nonpossessory security interests on qualified exempt property are voidable to the extent they impair exemptions, FN147 except when section 522(f)(3) applies. FN148 The section 522(f)(3) limit applies only to "implements, professional books, or tools of the trade" and to "farm animals or crops." FN149 If "crops" means "farm crops," not "household crops" within the meaning of section 522(f)(1)(B)(i), then it can be said that the limit applies to security interests on the exempt items found in section 522(f)(1)(B)(ii) (income producing property). Nothing in section 522(f)(1)(B)(i) (consumer goods) is subject to the section 522(f)(3) defense. FN150

Oddly, section 522(f)(3) limits the debtor from avoiding security interests not only on her own property, but also upon property of "a dependent of the debtor." FN151 Yet, nothing in section 522(f) empowers a debtor to avoid the encumbrances of property of a dependent. FN152 Section 522(f)(1)(B)(i) and (ii) both allow a debtor to avoid security interests on her *own* property, when that property is used by a dependent. FN153 But this cannot mean that the debtor can avoid the secured obligations of dependents who are nondebtors. Hence, the reference in section 522(f)(3) is an unnecessary but harmless piece of nonsense.

A. Conditions Precedent

Whatever the limit in section 522(f)(3) means, it is subject to a pair of very difficult conditions precedent, to be found in subsections (A) and (B) of section 522(f)(3). FN154 Subsection (A) starts by requiring that state law either permit the waiver of exemptions under section 522(d) or prohibit the use of section 522(d). FN155 Most states prohibit the use of section 522(d), and so the condition in section 522(f)(3)(A) will usually be met. FN156 But in states where the federal exemptions are still available, the meaning of section 522(f)(3)(A) is not entirely clear. FN157 The section indicates that applicable state law must permit "a person to voluntarily waive a right to claim exemptions under subsection (d)." FN158 This language may mean that state legislatures must affirmatively permit debtors to waive their exemptions in a loan agreement. Few or perhaps no states do so, and therefore perhaps the section 522(f)(3) limit does not apply in any state where it is still possible for debtors to choose the federal exemptions. Oddly, section 522(e) prohibits such waivers, FN159 but perhaps the passage of an unconstitutional waiver law at the state level triggers the procreeitor limitation on the debtor's avoidance power. This is not a sensible state of affairs.

Section 522(f)(3)(A) may mean something else. It may simply mean that, if the debtor chooses the federal exemption, the limit does not apply. FN160 But if the debtor chooses the state exemption, section 522(f)(3) curtails the debtor's ability to avoid liens. FN161 Or, in other words, section 522(f)(3)(A) is met in any case where the debtor actually chooses state, and not the federal exemptions. FN162 The legislative history supports this reading as follows:

[This section] applies only in cases in which the debtor has voluntarily chosen the State exemptions rather than the Federal bankruptcy exemptions or has been required to utilize State exemptions because a State has opted out of the

Federal exemptions. In such case, if the State allows unlimited exemption of property or prohibits avoidance of a consensual lien on property that could otherwise be claimed as exempt, the debtor may not avoid a security interest on the types of property specified above under Bankruptcy Code section 522(f)(2) to the extent the value of such property is in excess of \$5000. This section has no applicability if the debtor chooses the Federal bankruptcy exemptions, which cannot be waived. Like other exemption provisions, the new provision applies separately to each debtor in a joint case. FN163

In *In re Zimmer*, FN164 creditors suggested such a reading of section 522(f)(3)(A). FN165 But Judge Dennis O'Brien showed barely any desire to help out an inarticulate Congress and hinted that section 522(f)(3) simply might not apply in states where its residents have access to the federal exemptions. **FN166**

The second condition precedent, in section 522(f)(3)(B), requires that state law either (i) permit unlimited exemption of debtor equity in collateral, or (ii) prohibit avoidance of security interests on exempt property. FN167 Thus, subparagraph (B) is met whenever state law authorizes exemptions unlimited in amount. FN168 But, if the exemption has a monetary limit, then state law must *affirmatively prohibit* avoidance to comply with the second condition precedent. FN169

Louisiana, FN170 Texas FN171 and Wisconsin FN172 have enacted laws that meet the condition. FN173 According to one commentator, Texas had reacted to *Owen v. Owen* with "a feeble attempt to protect creditors' valid liens." FN174 Congress then responded with its amendment to section 522(f) in order to ratify what the Texas legislature had done. FN175 Thus, Congress and Texas were involved in a procreeitor dialectic to whittle down debtor protection under section 522(f)(1)(B).

Other states, however, simply recognize that exemption statutes apply to judicial lien creditors, but never to secured parties under Article 9. FN176 In *Zimmer*, Judge O'Brien ruled that mere inapplicability of exemptions to Article 9 security interests was not the same as an affirmative prohibition of avoidance. FN177 Given the merely passive law of Minnesota, FN178 coupled with monetarily limited exemptions, Judge O'Brien ruled that Minnesota debtors had unlimited avoidance rights on exempt property governed by a monetary limit. **FN179** Since Minnesota limited the farm equipment exemption to \$13,000, the debtors had unlimited avoidance powers against nonpurchase-money secured parties. FN180 Thus, at least in Minnesota, the limit is a dead letter.

B. The Nature of the Limit

When the section 522(f)(3) limit applies, the amount of lien avoidance no longer equates with the amount of impairment. FN181 Rather, lien avoidance is a lesser amount. FN182 Impairment is subject to a deduction, which is defined as the difference between the value of the collateral minus \$5000. FN183 According to section 522(f)(3):

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) either permits the debtor to claim exemptions under State law without limitation in amount, except as 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;

the debtor may not avoid the fixing of a lien on an interest of the debtor or 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 \$5000. FN184

Although the matter is not entirely clear, the section 522(f)(3) limit apparently requires a debtor to aggregate all "implements, professional books, tools of the trade of the debtor . . . or farm animals or crops of the debtor . . . to the extent the value of such implements, professional books, tools of the trade, animals and crops exceeds \$5000." FN185

It is possible, however, that Congress meant for the debtor to have a maximum of \$5000 *per item*, instead of \$5000 in the aggregate. The grammar of section 522(f)(3) suggests the latter aggregate approach is the answer. [FN186](#) Thus, if the debtor is subject to the section 522(f)(3) limit and has three items each worth \$4000, the limit applies. The debtor can avoid some of the security interests, but must end up with a maximum exemption of \$5000 spread over the three items. [FN187](#)

The section 522(f)(3) limit withdraws avoidance otherwise provided for under section 522(f)(1)(B). [FN188](#) Hence, we must first determine the extent to which a security interest impairs an exemption, per the formula of section 522(f)(2). [FN189](#) The limit then withdraws avoidance of that security interest by a defined amount. The amount withdrawn is the difference between the value of the collateral and \$5000. [FN190](#) Hence, it is wrong to think that section 522(f)(3) limits the debtor to exemptions worth \$5000, or that avoidance is directly related to \$5000. [FN191](#) Rather, the limit on avoidance is the difference between the value of the collateral and \$5000.

An example may help, or at least couldn't hurt. Suppose a debtor claims a \$50,000 vehicle as an exempt tool of the trade. [FN192](#) The vehicle is encumbered with a \$100,000 nonpurchase-money security interest. To determine whether the \$100,000 security interest "impairs" the exemption, we apply the formula of section 522(f)(2). [FN193](#) Accordingly, we take the sum of the suspect lien (\$100,000), all other liens (\$0), and the amount of the exemption (\$50,000). [FN194](#) From this sum (\$150,000), we subtract the unencumbered value of the truck (\$50,000). The amount of avoidance, then, is \$100,000. [FN195](#) Under section 522(f)(2), the entire \$100,000 security interest is void, but section 522(f)(3) defends the security interest by the difference between the value of the collateral (\$50,000) and \$5000. [FN196](#) Hence, the secured party has a \$45,000 defense, and a security interest that survives in this amount. The debtor has a senior exemption "lien" of \$5000 on the vehicle, and the secured party has a valid security interest on the remainder. [FN197](#)

While this result is sensible and in accord with the intent that the debtor's interest be limited to \$5000, the limit is quite cruel when applied to cases where the debtor has an exemption limited by monetary amount. Suppose now that only \$2400 of the truck is exempt. Once again we must apply the formula of section 522(f)(2) to figure out whether the security interest "impairs" the exemption. Accordingly, we take the sum of the suspect lien (\$100,000), all other liens (\$0), and the amount of the exemption (\$2400). [FN198](#) From this sum (\$102,400), we subtract the unencumbered value of the truck (\$50,000). The amount of avoidance, then, is \$52,400. [FN199](#) Under section 522(f)(2), the \$100,000 security interest only partly impairs the exemption. The secured party has a valid security interest for \$47,600, and the debtor may avoid \$52,400 of the lien. But section 522(f)(3) now works to withdraw some of that avoidance. Since section 522(f)(3) defends the security interest by the difference between the value of the collateral (\$50,000) and \$5000, the secured party has a defense worth \$45,000. [FN200](#) This amount must now be withdrawn from the avoidance of \$52,400, so that the debtor can avoid only \$7600 of the lien. Accordingly, section 522(f) reduces the \$100,000 lien to \$92,400. The truck is once again overencumbered, and the debtor has lost the exemption entirely.

One commentator, Scott Everett, gives the following alarming example. Suppose three debtors each suffer from \$10,000 security interests on property which they may exempt for \$5000. [FN201](#) The only difference is that the first debtor's property is valued at \$5000, the second debtor's property at \$7000, and the third debtor's property at \$10,000. [FN202](#) The first debtor emerges from bankruptcy with exempt property worth \$5000, the second with property worth \$4000, and the third with no exemption at all.

In a reversal of typical roles, [section] 522(f) debtors would, in this situation, have every incentive during the bankruptcy case to increase their surplus by showing how little their property is worth, while [section] 522(f) creditors would work to decrease the avoidance of their [section] 522(f) liens by showing how valuable the subject property is. [FN203](#)

Everett also points out that, in Texas, debtors are better off choosing the \$1500 federal exemption for tools of the trade. [FN204](#) instead of Texas's \$60,000 aggregate personal property exemption. [FN205](#) The latter triggers the section 522(f)(3) limit, and the whole exemption may be lost. [FN206](#) The federal choice prevents the limit from being used. [FN207](#) At least this is so on a certain reading of section 522(f)(3)(A). Recall that perhaps section 522(f)(3)(A) has been met only if the debtor has "waived" the federal exemption by choosing the state exemption. [FN208](#) On the other hand, section 522(f)(3)(A) may also mean that the section 522(f)(3) limit *only* applies in states where the debtor is

permitted to "waive" exemptions by contract. [FN209](#)

In *Zimmel*, Judge Dennis O'Brien ruled that the section 522(f)(3) limit would not apply in any Minnesota case. [FN210](#) Minnesota provided an exemption on tools that was limited by monetary amount. [FN211](#) The above example shows that when exempt property is overencumbered, the debtor will lose the exemption altogether, if the section 522(f)(3) formula applies. Such a result strongly supports Judge O'Brien's conclusion in Minnesota cases, at least on policy grounds.

In addition, the section 522(f)(3) limit is quite harsh when valid senior purchase money security interests encumber totally exempt property. Suppose a \$45,000 purchase money security interest and a junior \$100,000 nonpurchase-money lien encumber a \$50,000 truck. Applying the formula of section 522(f)(2), we take the sum of the suspect lien (\$100,000), all other liens (\$40,000), and the amount of the exemption (\$50,000). [FN212](#) From this sum (\$190,000), we subtract the unencumbered value of the truck (\$50,000). The amount of avoidance is \$140,000. [FN213](#) Under section 522(f)(2), the \$100,000 security interest is entirely void. The section 522(f)(3) limit now works to withdraw \$45,000 worth of avoidance, so that the debtor can only avoid \$95,000 worth of the security interest. [FN214](#) This leaves the secured party with a \$5000 security interest, just enough to wipe out the debtor's \$5000 exemption. Once again, the debtor has lost her exemption entirely. [FN215](#)

The section 522(f)(3) limit can also skew results between junior and senior nonpurchase-money creditors when they do not claim the same collateral. Suppose *A* claims \$10,000 and is senior to a pair of exempt items each worth \$4000. Following the "aggregate" interpretation of section 522(f)(3), [FN216](#) *A*'s collateral is worth \$8000. Suppose *B* claims \$10,000 and is junior to the two exempt items just mentioned, but senior as to a third item worth \$4000. If section 522(f) did not exist, *A* should recover \$8000 and *B* should recover \$6000. Under section 522(f)(1)(B) standing alone, all of these security interests are prima facie void. Thanks to the workings of section 522(f)(3), however, *B* recovers \$6000, while *A* only obtains a lien worth \$3000 an unfair result. First, we take the sum of *B*'s total claim (\$10,000), *A*'s valid security interest (which will turn out to be \$3000), and the debtor's exemption (\$12,000). [FN217](#) From this sum (\$25,000), we subtract the unencumbered value of the collateral (\$12,000), for avoidance of \$13,000. [FN218](#) But, *B* has a defense of \$7000 (the value of the collateral minus \$5000). [FN219](#) The debtor can only avoid \$6000 worth of the security interest. Hence, *B* has a valid \$4000 lien. This lien encumbers the item *A* could not reach.

A is worse off than *B*, even though *A* is senior. We take the amount of *A*'s lien (\$10,000), the amount of *B*'s valid lien (\$4000), the debtor's exemption (\$8000 for the two items of collateral), [FN220](#) and from this sum (\$22,000) we subtract the unencumbered value of the collateral (\$8000), for total avoidance of \$14,000. [FN221](#) *A* obtains a defense under section 522(f)(3), however, for \$3000 (\$8000 – \$5000). [FN222](#) The debtor can avoid \$11,000 worth of *A*'s lien, more than enough to wipe *A* out. Hence, *A*, a senior creditor, does worse than *B*, who is a junior creditor for two items and a senior creditor for only one. Obviously, this is an arbitrary and undesirable result.

CONCLUSION

The 1994 amendments to section 522(f) are only half successful. First, the amendments have added a very clear and concise definition of what "impairment" of an exemption means, for the purpose of lien avoidance under section 522(f)(1). This definition adopts the most prodebtor position existing in the diverse and unpredictable pre-amendment case law. Specifically, it adopts the prodebtor position taken by the Supreme Court in *Owen v. Owen*.

In contrast, the defense provided secured creditors under section 522(f)(3) is not well thought out. It is obtuse, absurd, and produces manifestly arbitrary and unfair results. While the idea of it is to prevent the debtor from avoiding security interests on extremely expensive tools of the trade, under certain circumstances, it ends up threatening the debtor's exemption altogether. It is clear that Congress will have to redesign the structure of section 522(f)(3). For example, Congress may wish to place a cap of \$5000 on the exemption of any tool of the trade. This cap might apply to benefit unsecured as well as secured creditors. Alternatively, Congress may simply try a general standard instead of a specific formula for avoidance. For example, if section 522(f)(3) simply stated that, with regard to tools, the debtor may never exempt more than \$5000 worth, the courts could then utilize the case law to smooth out the exact workings of the limit. These would be more sensible and less arbitrary ways to prevent debtor abuses of these valuable exemptions than the current formula.

Footnotes

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FN1 11 U.S.C. §§ 101–1330 (1994).

FN2 FTC Credit Practices Rule, 16 C.F.R. § 444.2(a)(4) (1994). *See* Jean Braucher, *Defining Unfairness: Empathy and Economic Analysis at the Federal Trade Commission*, 68 B.U. L. REV. 349, 415 (1988) (stating that FTC prohibits nonpossessory, nonpurchase–money security interests).

FN3 *See* Bankruptcy Reform Act of 1978, § 522(f), 11 U.S.C. § 522(f)(1) (1994). Section 522(f)(1), after extensive amendments in 1994, reads as follows:

Notwithstanding 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 impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is

....

(B) a nonpossessory, nonpurchase–money security interest in any

(i) 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;

(ii) implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor; or

(iii) professionally prescribed health aids for the debtor or a dependent of the debtor.

Id.

FN4 H.R. REP. NO. 595, 95th Cong., 1st Sess. 127 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6088 (stating these liens are often used by over–reaching creditors to their advantage).

FN5 *Id.*

FN6 11 U.S.C. § 522(f) (1988), *amended by* 11 U.S.C. § 522(f) (1994).

FN7 *See* Production Credit Ass'n v. LaFond (*In re* LaFond), 791 F.2d 623, 627 (8th Cir. 1986) (Heaney, J.) (allowing liens on large valuable farm equipment to be avoided because it was a tool of the trade); Middleton v. Farmers State Bank (*In re* Middleton), 45 B.R. 744, 747 (Bankr. D. Minn. 1985) (Connelly, J.) (same); Yparrea v. Roswell Prod. Credit Ass'n (*In re* Yparrea), 16 B.R. 33, 34 (Bankr. D. N.M. 1981) (Johnson, J.) (same).

FN8 73 B.R. 149 (Bankr. 9th Cir. 1987) (Ashland, J.), *aff'd*, 861 F.2d 550 (9th Cir. 1988).

FN9 *Taylor*, 73 B.R. at 152.

FN10 *See* Hon. Roger M. Whelan et al., *Consumer Bankruptcy Reform: Balancing the Equities in Chapter 13*, 2 AM. BANKR. INST. L. REV. 165, 186 (1994) (indicating creditor movement to amend § 522(f) in order to take a more limited approach to lien avoidance).

FN11 *See* ITT Fin. Servs. v. Fox (*In re* Fox), 902 F.2d 411, 414 (5th Cir. 1990) (Garwood, J.) (finding Mississippi exemption statute did not allow debtor to avoid lien by secured creditor on otherwise exempt property); Bessent v.

United States (*In re Bessent*), 831 F.2d 82, 83 (5th Cir. 1987) (Jones, J.) (Louisiana) (finding Texas statute did not allow for avoidance of lien); *Spears v. Thorp Credit, Inc. (In re Spears)*, 744 F.2d 1225, 1225–26 (6th Cir. 1984) (per curiam) (reaching same outcome under Ohio law).

FN12 David Gray Carlson, *Security Interests on Exempt Personal Property: Their Fate in Bankruptcy*, 2 J. BANKR. L. & PRAC. 247, 259–60 (1993).

FN13 *Id.*

FN14 500 U.S. 305 (1991) (Scalia, J.).

FN15 *Id.* at 313–14.

FN16 Bankruptcy Reform Act of 1994, § 303, 11 U.S.C. § 522(f)(2), (3) (1994).

FN17 See H.R. REP. NO. 835, 103d Cong., 2d Sess. 52–54 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3361–63 (indicating Congress intended to overrule several procreditor cases).

FN18 *Id.* at 52, *reprinted in* 1994 U.S.C.C.A.N. at 3361.

FN19 *Id.*

FN20 11 U.S.C. § 522(f)(3) (1994).

FN21 *Id.*

FN22 As this essay focuses on the meaning of the 1994 amendments, it does not discuss a great many issues under § 522(f)(1)(B). I have attempted to perform this task elsewhere. See Carlson, *supra* note 12, at 274 (containing a detailed discussion of pre–1994 § 522(f)).

FN23 See *infra* notes 176–80 and accompanying text.

FN24 11 U.S.C. § 522(f)(1) (1994).

FN25 Carlson, *supra* note 12, at 259.

FN26 *Id.* A similar phenomenon exists with regard to property of the estate. According to § 541(a)(1), only the *debtor's interest* in property enters the estate, leaving the implication that the security interest is beyond the jurisdiction of the estate. See 11 U.S.C. § 541(a)(1) (1994). It is necessary to deny this implication in order to affirm a bankruptcy trustee's power to use, sell or lease illiquid collateral under § 363(b). See David Gray Carlson, *The Dubious Foundations of Securitization* 10–13 (unpublished manuscript on file with author).

FN27 Apparently, some states even amended their exemption statutes to help secured parties achieve this implication. See James B. Haines, Jr., *Section 522's Opt-Out Clause: Debtors' Bankruptcy Exemptions in a Sorry State*, 1983 ARIZ. ST. L.J. 1, 25–26 (1983).

FN28 See *ITT Fin. Servs. v. Fox (In re Fox)*, 902 F.2d 411, 414 (5th Cir. 1990) (Garwood, J.) (reaching this result under Mississippi law); *Bessent v. United States (In re Bessent)*, 831 F.2d 82, 83–84 (5th Cir. 1987) (Jones, J.) (Louisiana); *Spears v. Thorp Credit, Inc. (In re Spears)*, 744 F.2d 1225, 1225–26 (6th Cir. 1984) (per curiam) (Ohio law); *Allen v. Hale County State Bank (In re Allen)*, 725 F.2d 290, 292–93 (5th Cir. 1984) (Politz, J.) (Texas); *Giles v. Credithrift of America, Inc. (In re Pine)*, 717 F.2d 281, 284 (6th Cir. 1983) (Merritt, J.) (Tennessee and Georgia), *cert. denied*, 466 U.S. 928 (1984). For a rare case of rebellion by a lower court against the governing authorities of the Fifth Circuit, see *In re Thompson*, 59 B.R. 690, 692 (Bankr. W.D. Tex. 1986). Here Judge Glen Ayers wrote: "Were the Fifth Circuit confronted with *Allen* today, it would almost certainly not render the same decision." *Id.* at 695. The

prediction proved incorrect, as the Fifth Circuit has reiterated its position at least twice since *Allen*, in *Fox* and *Bessent*.

Other courts thought that if any part of the item is exemptible if the debtor's equity may be reserved by the debtor then § 522(f)(1)(B) may destroy any security interest on the item. *See Aetna Fin. Co. v. Leonard (In re Leonard)*, 866 F.2d 335, 337 (10th Cir. 1989) (Brorby, J.); *Hall v. Finance One, Inc. (In re Hall)*, 752 F.2d 582, 586 (11th Cir. 1985) (Kravitch, J.); *Brown v. Dellinger (In re Brown)*, 734 F.2d 119, 125 (2d Cir. 1984) (Kearse, J.); *Maddox v. Southern Discount Co. (In re Maddox)*, 713 F.2d 1526, 1530 (11th Cir. 1983) (per curiam).

FN29 500 U.S. 305 (1991) (Scalia, J.).

FN30 *See id.* at 313–14 (concluding that Florida's exclusion of certain liens from scope of its homestead protection does not achieve a similar exclusion from Bankruptcy Code's lien avoidance provision).

FN31 *Id.* at 309.

FN32 11 U.S.C. § 522(f)(1)(A) (1994).

FN33 *Tower Loan, Inc. v. Maddox (In re Maddox)*, 15 F.3d 1347, 1351 (5th Cir. 1994) (Wiener, J.); *In re Wink*, 137 B.R. 297, 300 (Bankr. W.D. Wis. 1992) (Utschig, J.).

FN34 *Owen*, 500 U.S. at 307.

FN35 *Id.* at 306–07.

FN36 *Id.* at 307.

FN37 *Id.*

FN38 11 U.S.C. § 522(f)(1)(A) (1994) (emphasis added).

FN39 *Owen*, 500 U.S. at 311–12.

FN40 Scalia thought that the ex–wife's argument had some merit, but he worried about its consistency with what he termed a "uniform practice of bankruptcy courts," regarding the federal exemptions that most states have opted out of. *Id.* at 310. The federal rule allows exemption of "the debtor's interest" in the listed items. 11 U.S.C. § 522(d) (1994). This implies that only debtor equity is exempt. If the ex–wife were right, then § 522(f) could never invalidate an effective judicial lien (or perfected security interest) on a federally exempt item of property. Yet bankruptcy courts routinely allowed § 522(f) to avoid otherwise valid liens on federally exempt items. *See, e.g., In re Gifford*, 688 F.2d 447, 450 (7th Cir. 1982) (Cummings, J.).

This attitude seems entirely correct. The idea of the federal exemptions was to correct for the fact that many states had not amended their debtor–creditor laws since the nineteenth century. *See William J. Woodward, Jr., Exemptions, Opting Out, and Bankruptcy Reform*, 43 OHIO ST. L.J. 335, 341–42 (1982). Hence, many of the exemptions were pitiful by modern standards. Congress allowed debtors to have potentially better federal exemptions, but if states consciously thought highly enough of their own systems, they could "opt out" of the federal system in favor of exclusive state governance. 11 U.S.C. § 522(b) (1994).

Suppose a state permits the choice of federal exemptions, but the federal exemption protects only "the debtor's interest" in a given item. A judicial lien under state law might attach to such an item, reducing the "debtor's interest" in the item to zero. If the judicial lien on the item remained unavoidable, the debtor would gain nothing from the federal exemption. *Owen*, 500 U.S. at 310; C. Robert Morris, *Bankrupt Fantasy: The Site of Missing Words and the Order of Illusory Events*, 45 ARK. L. REV. 265, 272–73 (1992). It was necessary, then, that such judicial liens be destroyed by § 522(f)(1), so that the federal exemptions might do the debtor some good. *See Robert H. Bowmar, Avoidance of*

Judicial Liens that Impair Exemptions in Bankruptcy: The Workings of 11 U.S.C. § 522(f)(1), 63 AM. BANKR. L.J. 375, 387–88 n.85 (1989) (discussing New York's bankruptcy-only exemptions, to which judicial liens might attach).

Given this attitude toward federal exemptions, Scalia saw no valid reason to distinguish the state-law exemptions and so, in the interest of uniformity, he ruled that otherwise valid liens could be destroyed under § 522(f). *Owen*, 500 U.S. at 313–14.

FN41 *Id.* at 310–11.

FN42 *Id.* at 310–11 (emphasis added) (footnote omitted). This past subjunctive tense demands a "but for" against which the debtor is to be protected. One "but for" might be found in the opening words of § 522(f) "Notwithstanding any waiver of exemptions" This harmless "but for" would allow the ex-wife's judicial lien to survive.

Scalia rejected this argument, because the opening word "Notwithstanding" had already dispensed with the waiver. Given that the waiver had been neutralized, the "but-for" of the "would have been" must be something other than the waiver. *Id.* at 310. "The only other conceivable possibility is *but for a waiver* harking back to the beginning phrase of § 522(f) The use of contrary-to-fact construction after a 'notwithstanding' phrase is not, however, common usage, if even permissible." *Id.* at 311. Furthermore, the destruction of waivers in § 522(f) is merely an aside. The main point of § 522(f) is to destroy liens, suggesting that the "but for" must be aimed at the lien, not the waiver of exemption. *Id.* at 312.

One argument not available to Justice Scalia, who interpreted § 522(f)(1)(A), applies to § 522(f)(1)(B) the creation of a security interest in exempt property can be viewed as a *waiver* of the exemption; hence, § 522(f)(1)(B) should destroy security interests "notwithstanding waiver," to quote the opening words of § 522(f). *See McManus v. Avco Fin. Servs., Inc. (In re McManus)*, 681 F.2d 353, 358 (5th Cir. 1982) (Dyer, J., dissenting).

FN43 *Owen*, 500 U.S. at 311. One aspect of the case, emphasized in Justice Stevens' dissent, is that Mr. Owen's condo became exempt only after Mrs. Owen's judicial lien encumbered the asset. *Id.* at 315 (Stevens, J., dissenting). Therefore, on the logic of the majority opinion, it ought to be possible in general to disencumber collateral that was never exempt by rendering it exempt. For example, suppose a debtor brings home encumbered office furniture, thereby rendering the furniture exempt. The security interest on that office furniture should effectively disappear, so long as it was of the nonpurchase-money variety. *See Tower Loan, Inc. v. Maddox (In re Maddox)*, 15 F.3d 1347, 1351–52 (5th Cir. 1994) (Wiener, J.) (security interest on nonexempt property could be avoided if debtor later designated the collateral as exempt per Mississippi law); *In re Hilary*, 76 B.R. 683, 685 (Bankr. D. Minn. 1987) (Kressel, J.) (violin used for business could be converted into home instrument, though exemption disallowed for other reasons). *But see In re Rader*, 144 B.R. 864, 866 (Bankr. W.D. Mo. 1992) (Koger, J.) (concluding judicial lien attached first and the property was ruled exempt after the fact); *In re Goodwin*, 133 B.R. 141, 144 (Bankr. S.D. Ind. 1990) (Vandivier, J.) (estopping debtor's claim that furniture was exempt household furnishing because secured party relied on representation that furniture was for office).

FN44 *Cf. In re Mayer*, 156 B.R. 54, 59 (Bankr. S.D. Cal. 1993) (Adler, J.). *Mayer* held the use of § 522(f) to reduce valid judicial lien an unconstitutional taking. *Id.* It is hard indeed to reconcile *Mayer* with *Owen v. Owen*, which palpably allows the reduction of a judicial lien that was valid under state law. *Owen*, 500 U.S. at 313–14.

It may also be noted that the 1994 amendments to § 522(f)(1)(A) prevent the avoidance of any judicial lien related to family obligations. 140 CONG. REC. H10,752, H10,770 (daily ed. Oct. 4, 1994). These amendments were specifically intended to expand the scope of *Farrey v. Sanderfoot*, which held a former husband could not avoid a judicial lien on a residence previously owned jointly with his former wife. *Id.* (citing *Farrey v. Sanderfoot*, 500 U.S. 291 (1991)).

FN45 *See* 11 U.S.C. § 522(f)(1)(B) (1994) (allowing avoidance of security interest in various types of personal property to extent lien impairs an exemption).

FN46 *Owen*, 500 U.S. at 313. On the other hand, in *In re Johnson*, 179 B.R. 800 (Bankr. E.D. Va. 1995), the debtor tried to claim a car as exempt which was encumbered by an unperfected purchase money security interest. *Id.* at 801–02. Virginia has an exemption statute that prevents any property from being exempt when purchase money debt is still outstanding, even if the purchase money debt is unsecured. VA. CODE ANN. § 34–5(1) (Michie 1990 & Supp. 1995). Nothing in *Owen* could help the debtor in her quest to disencumber the car. Even if we suspended the lien per Justice Scalia's instruction, the car still would not be exempt.

FN47 See *Owen*, 500 U.S. at 313 (indicating that identical reasoning is applicable to both federal and state exemptions).

FN48 11 U.S.C. § 522(f)(3) (1994).

FN49 See 140 CONG. REC. S4640, S4645 (daily ed. Apr. 21, 1994) (statement of Sen. Johnston) (indicating that it was the effect of *Owen* on agricultural borrowers that was the primary motivational force).

FN50 This follows by negative implication because the § 522(f)(3) limitation on avoidance only applies when the collateral's value exceeds \$5000. See 11 U.S.C. § 522(f)(3) (1994).

FN51 See *id.* (indicating that, if applicable, debtor "may not avoid" liens subsection (1) would allow).

FN52 11 U.S.C. § 522(f)(1) (1994).

FN53 *Id.* § 522(f)(1)(B).

FN54 See *id.*

FN55 See generally Paulette J. Delk, *Lien Avoidance Under Section 522(f) of the Bankruptcy Code: The Winding Road to the Supreme Court*, 26 WAKE FOREST L. REV. 879, 881–83 (1991) (discussing how concurrent enactment of § 522(b) created difficulty for courts trying to apply § 522(f)); Lawrence Kalevitch, *Lien Avoidance on Exemptions: The False Controversy Over Opt–Out*, 44 OKLA. L. REV. 443, 444 (1991) (discussing how courts and commentators had reached incorrect conclusions under pre–1994 avoidance provision).

FN56 11 U.S.C. § 522(f)(2)(A) (1994). According to the legislative history, this formulation was adopted in *In re Brantz*, 106 B.R. 62 (Bankr. E.D. Pa. 1989). 140 CONG. REC. H10,752, H10,769 (daily ed. Oct. 4, 1994). Additionally, *Brantz* was cited with favor in *Owen*. See *Owen v. Owen*, 500 U.S. 305, 313 n.5 (1991) (Scalia, J.).

FN57 11 U.S.C. § 522(f)(1)(B)(ii) (1994).

FN58 *Id.* § 522(f)(1)(B).

FN59 *Id.* § 522(d)(2).

FN60 *Id.* § 522(f)(2)(A)(i)–(iii).

FN61 *Id.* § 522(f)(2)(A).

FN62 11 U.S.C. § 522(f)(2)(A) (1994).

FN63 *Id.* § 522(f)(1).

FN64 500 U.S. 305, 310–11 (1991) (Scalia, J.).

FN65 *Id.* at 311.

FN66 *Id.* at 312.

FN67 For a discussion of how depreciation and appreciation affect secured creditors, see Margaret Howard, *Multiple Judicial Liens in Bankruptcy: Section 522(f)(1) Simplified*, 67 AM. BANKR. L.J. 151, 173–75 (1993).

FN68 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 Texas Personal Property Exemptions*, 26 TEX. TECH L. REV. 1331, 1353 (1995).

FN69 When Hamlet asks Rosencrantz and Guildenstern how they fared, the latter responded, "Happy in that we are not overhappy; On Fortune's cap we are not the very button." WILLIAM SHAKESPEARE, *THE TRAGEDY OF HAMLET, PRINCE OF DENMARK* act 2, sc. 2.

FN70 11 U.S.C. § 522(f)(1)(B)(ii) (1994).

FN71 Later, we shall see that A's \$600 lien is valid for \$250 and invalid for \$350. *See infra* notes 74–77 and accompanying text.

FN72 11 U.S.C. § 522(f)(2)(A)(i)–(iii) (1994).

FN73 *Id.* § 522(f)(2)(A).

FN74 *Id.* § 522(f)(2)(B).

FN75 *Id.* § 522(f)(2)(A).

FN76 *Id.*

FN77 *See* 11 U.S.C. § 522(f)(1) (1994).

FN78 If we had started with A's senior security interest, A's lien would have been avoided entirely, but B's junior lien would have been valid to the extent of \$250.

FN79 *See* 11 U.S.C. § 506(a) (1994) (providing that a secured claim is an allowed secured claim "to the extent of the value of such creditor's interest in the estate's interest in such property").

FN80 *Id.* § 522(f)(2)(A).

FN81 *Id.* § 522(f)(1)(B).

FN82 The phrase "secured claim" is supposed to be tied to the value of the collateral. *See* 11 U.S.C. § 506(a) (1994). *But see* *Dewsnup v. Timm*, 502 U.S. 410, 417 (1992). A "secured claim" means the entire prepetition claim of an undersecured creditor, for purposes of § 506(d). *Id.* In any case, the phrase "secured claim" is not used in § 522(f)(2), and the word "lien" is not defined according to any quantitative criterion. *See* 11 U.S.C. § 101(37) (1994) ("lien" defined as a "charge against or interest in property to secure payment of a debt or performance of an obligation").

FN83 *See* Howard, *supra* note 67, at 164–65 (referring to underwater liens as junior liens where debtor's exemption and senior liens exceed value of property).

FN84 11 U.S.C. § 522(f)(2) (1994); *see supra* notes 52–66 for a discussion of the formula.

FN85 11 U.S.C. § 522(f)(1)(B)(ii) (1994).

FN86 *See id.* § 522(f)(1)(B) (providing avoidance only for nonpossessory, nonpurchase–money security interests).

FN87 Many cases took this position prior to 1994. *See Henderson v. Belknap (In re Henderson)*, 18 F.3d 1305, 1310–11 (5th Cir.) (per curiam) (allowing avoidance of \$197,667 judicial lien when debtor had no equity above homestead exemption), *cert. denied*, 115 S. Ct. 573 (1994); *Harris v. Herman (In re Herman)*, 120 B.R. 127, 132 (Bankr. 9th Cir. 1990) (Perris, J.) (allowing avoidance of junior lien where debtor's \$75,000 exemption and \$90,000 senior lien took up entire \$149,500 value of collateral); *Galvan v. Galvan (In re Galvan)*, 110 B.R. 446, 451–52 (Bankr. 9th Cir. 1990) (Meyers, J.) (allowing debtor to avoid \$32,182 junior lien when homestead with fair market value of \$94,500 is encumbered by \$82,207 senior trust deed and debtor has \$45,000 exemption); *In re Koehler*, 167 B.R. 773, 775 (Bankr. W.D.N.Y. 1994) (Bucki, J.) (allowing to survive only portion of junior lien above senior lien and debtor's exemption); *In re Bruton*, 167 B.R. 923, 926–27 (Bankr. S.D. Cal. 1994) (Adler, J.) (stating that junior lien is avoided entirely if debtor has no equity above senior liens and debtor's exemption); *Wilder v. Buckeye Union Ins. Co. (In re Wilder)*, 165 B.R. 413, 416 (Bankr. W.D. Va. 1994) (Pearson, J.) (avoiding junior lien where debtor had no equity above senior liens and its exemptions); *In re Cross*, 164 B.R. 496, 500–01 (Bankr. E.D. Pa. 1994) (Scholl, J.) (same); *In re Finn*, 151 B.R. 25, 28 (Bankr. N.D.N.Y. 1992) (Gerling, J.) (same); *In re Berrong*, 53 B.R. 640, 643 (Bankr. D. Colo. 1985) (Brumbaugh, J.) (same); *In re Rehbein*, 49 B.R. 250, 253–54 (Bankr. D. Mass. 1985) (Glennon, J.) (same); *In re Carney*, 47 B.R. 296, 299 (Bankr. D. Mass. 1985) (Gabriel, J.) (same); *see also* Bowmar, *supra* note 40, at 388–89 (arguing in favor of permitting avoidance of junior liens where debtor has no equity above senior avoidable liens).

FN88 *See supra* notes 52–66 (discussing § 522(f)(2) formula).

FN89 *See* 11 U.S.C. § 522(f)(2) (1994) (containing no express rule for order of calculation of multiple liens).

FN90 *See* text *supra* p. 66.

FN91 This figure might be viewed as \$250, because only that amount of the senior lien is valid. Whether \$1000 or \$250 is used, however, makes no mathematical difference, insofar as the junior lien's validity is concerned.

FN92 11 U.S.C. § 522(f)(2)(A)(i)–(iii) (1994).

FN93 *Id.* § 522(f)(2)(A).

FN94 *Id.* § 522(f)(1)(B).

FN95 It will be recalled that new § 522(f)(2)(B) prohibits us from adding in *B*'s avoided lien here. *Id.* § 522(f)(2)(B).

FN96 *Id.* § 522(f)(2)(A)(i)–(iii).

FN97 11 U.S.C. § 522(f)(2)(A) (1994).

FN98 *Id.* § 522(f)(1).

FN99 *See id.*

FN100 *See, e.g., Wrenn v. American Cast Iron Pipe Co. (In re Wrenn)*, 40 F.3d 1162, 1166 (11th Cir. 1994) (per curiam) (holding judgment lien could be avoided only to extent of exemption); *David Dorsey Distrib., Inc. v. Sanders (In re Sanders)*, 39 F.3d 258, 261 (10th Cir. 1994) (Moore, J.) (stating appreciation of property should be subject to prior lien); *City Nat'l Bank v. Chabot (In re Chabot)*, 992 F.2d 891, 895 (9th Cir. 1993) (Sneed, J.) (noting exemption is not impaired unless it is diminished in value); *Wachovia Bank & Trust Co. v. Opperman (In re Opperman)*, 943 F.2d 441, 444 (4th Cir. 1991) (Ward, J.) (avoiding lien when it interferes with debtor's exemption). *Compare In re Cross*, 164 B.R. 496, 500 (Bankr. E.D. Pa. 1994) (Scholl, J.) (stating that *Owen* compels destruction of underwater liens under § 522(f)) *with In re Harrison*, 164 B.R. 611, 615 (Bankr. N.D. Ill. 1994) (Squires, J.) (rejecting argument that *Owen* compels destruction of underwater liens).

One court thought that *Dewsnup v. Timm*, 502 U.S. 410 (1992) itself required that the underwater liens be left alone. *In re Cerniglia*, 137 B.R. 722, 725 (Bankr. S.D. Ill. 1992) (Meyers, J.). Other courts thought that a debtor has no property interest in overencumbered property. *Opperman*, 943 F.2d at 443–44; *In re Cheek*, 111 B.R. 828, 830 (Bankr. E.D. Mo. 1990) (Schermer, J.). Still other courts admitted that the debtor has ownership of overencumbered property, but they found that the underwater lien does not "impair" any exemption. *Menell v. First Nat'l Bank (In re Menell)*, 37 F.3d 113, 116 (3d Cir. 1994) (Cowen, J.); *Simonson v. First Bank (In re Simonson)*, 758 F.2d 103, 109–11 (3d Cir. 1985) (Becker, J., dissenting); *Alu v. New York (In re Alu)*, 41 B.R. 955, 957–58 (E.D.N.Y. 1984) (Wexler, J.); *Washington v. Virginia State Educ. Assistance Auth. (In re Washington)*, 41 B.R. 211, 216 (Bankr. E.D. Va. 1984) (Shelley, J.).

None of these theories is very defensible, and because Congress has overruled them, any demonstration would constitute a digression. *See* 11 U.S.C. § 522(f)(2) (1994).

FN101 The legislative history specifically mentions an intent to overrule *City Nat'l Bank v. Chabot*, 992 F.2d 891, 895 (9th Cir. 1993). 140 CONG. REC. H10,752, H10,769 (daily ed. Oct. 4, 1994).

FN102 185 B.R. 786, 788 (Bankr. D. Minn. 1995) (O'Brien, J.).

FN103 *Id.* at 788.

FN104 This part of the case is discussed *infra* in the text accompanying notes 176–180.

FN105 *Zimmel*, 185 B.R. at 795.

FN106 *See* 11 U.S.C. § 522(i)(2) (1994) (granting power to debtor to avoid in lieu of trustee's action).

FN107 *See Zimmel*, 185 B.R. at 788; *see also* 11 U.S.C. § 510(a) (1994) (governing validity of subordination agreements in bankruptcy).

FN108 *See* David Gray Carlson, *The Trustee's Strong Arm Power in Bankruptcy*, 43 S.C. L. REV. 841, 887–93 (1992) (discussing requirements for bringing marshaling claims); *see also* *Duck v. Wells Fargo Bank (In re Spectra Prism Indus.)*, 28 B.R. 397, 399 (Bankr. 9th Cir. 1983) (Katz, J.) (discussing basic requirements that must be met before imposition of marshaling orders).

FN109 Moses Lachman, Note, *Marshaling Assets in Bankruptcy: Recent Innovations in the Doctrine*, 6 CARDOZO L. REV. 671, 671 (1985).

FN110 *Id.*

FN111 *Id.*

FN112 *See Duck*, 28 B.R. at 399 ("All parties agree that injury or prejudice to a third party constitutes adequate grounds to deny an order to marshal assets.").

FN113 *Id.* at 399–400.

FN114 *See* Carlson, *supra* note 108, at 887–93 (indicating marshaling is only proper when it will not result in prejudice to other parties); Lachman, *supra* note 109, at 672–73 (stating marshaling is only proper where result will not prejudice "the debtor, senior creditor, or third persons").

FN115 11 U.S.C. § 544(a)(1) (1994).

FN116 *Id.*

FN117 See *Owens–Corning Fiberglas Corp. v. Center Wholesale, Inc. (In re Center Wholesale, Inc.)*, 788 F.2d 541, 544 (9th Cir. 1986) (Beezer, J.) (noting that marshaling must avoid injustice to third parties, including other lien creditors).

FN118 See *supra* text accompanying note 107 (defining security interest of A as avoidable).

FN119 David Gray Carlson, *Security Interests in the Crucible of Voidable Preference Law*, 1995 U. ILL. L. REV. 211, 357; Tracy Springer, Note, *An Individual Debtor's Right to Avoid Liens Under Section 506(d) of the Bankruptcy Code*, 12 CARDOZO L. REV. 263, 274 n.66 (1990).

FN120 See 11 U.S.C. § 522(i)(2) (1994) (stating that lien that is avoided under § 522(f) may be preserved for benefit of debtor).

FN121 See *id.*

FN122 At least one court has held that the lien preservation principle in § 551 does not include expropriation of contractual subordination rights of the avoided secured party. In *Robinson v. Howard Bank (In re Kors, Inc.)*, 819 F.2d 19, 23 (2d Cir. 1987), Judge Lawrence Pierce ruled that, when a trustee avoided an unperfected senior security interest, the trustee could preserve the avoided lien but could not assert that lien creditor's subordination rights created in a collateral contract. *Id.* I have criticized the logic of this ruling elsewhere. See Carlson, *supra* note 108, at 863–72. Nevertheless, if the case is considered good law, it constitutes a reason why the debtor would not be able to maneuver an avoidance right under § 522(f)(1)(B) to the prejudice of a valid junior lien.

FN123 *Ivie v. Frey (In re Ivie)*, 165 B.R. 477 (Bankr. D. Mont. 1994) (Peterson, J.) (debtor not permitted to shift mortgages to nonexempt property in order to create equity in a homestead which could be disencumbered under § 522(f)(1)).

FN124 The trustee is a lien creditor under the strong arm power. See 11 U.S.C. § 544(a)(1) (1994) (granting trustee rights and powers of lien creditor as of commencement of the case). The debtor's right to at least a monetary exemption in a thing has already been compared to a lien. See *supra* text accompanying notes 68–69.

FN125 See, e.g., 11 U.S.C. § 522(d)(2) (1994) (entitling debtor to exemption of one motor vehicle, not to exceed \$2400).

FN126 See John C. McCoid, *Preservation of Avoided Transfers and Liens*, 77 VA. L. REV. 1091, 1099 (1991) (indicating that circular priorities arise when trustee has priority over preferred creditor, who has priority over second mortgagee, that has priority over trustee).

FN127 11 U.S.C. § 522(d)(2) (1994).

FN128 See *id.* § 522(f)(1)(B) (allowing avoidance of only nonpossessory, nonpurchase–money liens).

FN129 See *In re Zimmer*, 185 B.R. 786, 788 (Bankr. D. Minn. 1995) (O'Brien, J.) (presenting parallel facts).

FN130 The trustee can benefit from a voidable preference recovery when the avoided interest was voluntarily conveyed by the debtor. The debtor cannot step into the trustee's shoes and avoid any such lien. 11 U.S.C. § 522(g) (1994).

FN131 See McCoid, *supra* note 126, at 1099 (detailing circumstances that give rise to circular priorities).

FN132 See, e.g., *In re Baldwin*, 84 B.R. 394, 396 (Bankr. W.D. Pa. 1988) (Bentz, J.) (presenting similar facts illustrating circular priorities).

FN133 Cf. *Fisher v. Pennsylvania (In re Fisher)*, 117 B.R. 191, 194 (Bankr. W.D. Pa. 1990) (Markovitz, J.). Where a debtor with a monetary portion and a creditor with an avoidable lien claim different pieces of collateral, the part of the lien not avoided still attaches to both pieces of property; apportionment to one piece only is not allowed. *Id.*

FN134 11 U.S.C. § 522(f)(2)(A)(i)–(iii) (1994).

FN135 *Id.* § 522(f)(2)(A).

FN136 *Id.* § 522(i).

FN137 *Id.* § 522(i)(2); Bowmar, *supra* note 40, at 397. One commentator argues against this reading of § 522(i):

Arguably, the reference in [§] 522(i)(2) to the exemption limitation of [§] 522(i)(1) is not pertinent in this context. Section 522(i)(1) permits exemption of property recovered by the debtor. When the debtor avoids a judicial lien, there is "avoidance" but no "recovery." The word "property" in [§] 522(i)(1) should be construed to refer to the physical subject matter of a lien and not to the lien itself. If the debtor avoids a transfer of property, the debtor may recover the property from the transferee, just as the trustee might have recovered such property had the trustee avoided the transfer. Arguably, however, the trustee does not "recover" a judicial lien that has been avoided. Even if, for certain purposes, a lien would be considered a type of property, a lien upon property of the debtor is not itself property of the debtor. The lien is not "recovered," because the lien, although the product of the avoided transfer, has not itself been transferred. The reference in [§] 522(i)(2) to "the extent that the debtor may exempt such property under . . . paragraph (1) of this subsection," should be connected to the earlier reference to a transfer avoided under subsection (h), not to one avoided under subsection (f).

Id. at 397–98 (footnotes omitted). In other words, only security interests avoided under § 522(g) can be preserved. Security interests preserved under § 522(f) to which § 522(i)(1) refers cannot be preserved. If Bowmar is right, then § 522(i) does not allow the debtor to take priority over the junior unavoidable security interest. *See In re Koehler*, 167 B.R. 773, 775 (Bankr. W.D.N.Y. 1994) (Bucki, J.) (refusing to preserve an avoided judicial lien for the debtor's benefit). But Bowmar's argument depends on the belief that the debtor does not "recover" property when she avoids a judicial lien. For Bowmar, "recover" means "regain possession of." As this is not a compelling definition of the word "recover," Bowmar's entire argument is vulnerable to rejection.

FN138 *See In re Blanks*, 64 B.R. 467, 469 (Bankr. E.D.N.C. 1986) (holding that avoided lien could be considered preserved to defeat junior lien).

FN139 *See* 2 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 39.2, at 1023 (1965) ("There has never been agreement on the correct solution of circular systems which arise . . . from . . . inconsistent rules . . .").

FN140 *Hazard v. Overhead Door Co. (In re Hazard)*, 113 B.R. 494, 497–98 (W.D. Wis. 1990) (Crabb, J.); *In re Bradshaw*, 156 B.R. 239, 243 (Bankr. S.D. Ind. 1993) (Lorch, J.); *West v. West (In re West)*, 68 B.R. 647, 650 (Bankr. C.D. Cal. 1986) (Ryan, J.); *Losieniecki v. Thrift Consumer Discount Co. (In re Losieniecki)*, 17 B.R. 136, 138 (Bankr. W.D. Pa. 1981) (Cosetti, J.); *see also* John T. Cross, *The Application of Section 522(f) of the Bankruptcy Code in Cases Involving Multiple Liens*, 6 BANKR. DEV. J. 309, 325–27 (1989) (stating that according to expansive approach, debtor could avoid liens to extent necessary to gain full advantage of its exemptions).

FN141 H.R. REP. NO. 835, *supra* note 17, at 52, *reprinted in* 1994 U.S.C.C.A.N. at 3361.

FN142 *See Nadel v. Mayer (In re Mayer)*, 167 B.R. 186, 188 (Bankr. 9th Cir. 1994) (stating exemptions are determined as of filing date); *Harris v. Herman (In re Herman)*, 120 B.R. 127, 130 (Bankr. 9th Cir. 1990) (same).

FN143 *Compare Silver v. Savings Bank (In re Fiore)*, 27 B.R. 48, 50 (Bankr. D. Conn. 1983) (Krechevsky, J.) ("To allow the debtor to place a voluntary lien on his property, and thereby to eliminate [A's] lien through the use of § 522(f) is an unjust result and should not be imputed to be Congress' purpose . . .") *with Simonson v. First Bank (In*

re Simonson), 758 F.2d 103, 110 (3d Cir. 1985) (Becker, J., dissenting) (indicating that Congress must have known desperate debtors would further encumber their exempt property in order to stave off bankruptcy) and *In re Green*, 64 B.R. 462, 464 (Bankr. S.D. Ind. 1986) (Bayt, J.) (stating that legislative history allegedly supports exemption planning of this sort). If the debtor does attempt a squeeze-out, the security interest might be a fraudulent conveyance. 11 U.S.C. § 548 (1994). Of course, the secured party has a defense under § 548(c) to the extent the secured party gave value to the debtor in good faith. *Id.* § 548(c). Fraudulent conveyance liability therefore depends on secured party knowledge of the squeeze-out and such, it is avoidable by the trustee. *Id.* §§ 544(b), 548(a)(1). The trustee would then preserve the avoided security interest for the benefit of general creditors, to the consternation of the secured party. *Id.* § 551. Yet even this fraudulent conveyance theory could not keep the debtor from obtaining the exemption to the extent of A's lien, under the expansive approach, unless the court were willing simply to declare the exemption under such circumstances to be itself fraudulent. See *Galvan v. Galvan (In re Galvan)*, 110 B.R. 446, 452 (Bankr. 9th Cir. 1990) (Meyers, J.). The *Galvan* court stated that, the judicial lien creditor may wish to challenge the bona fides of consensual liens in order to establish fully if there is any impairment of the debtor's exemption rights. We believe that in the context of a contested matter brought under [§] 522(f)(1), a judicial lien creditor can gain the necessary access to judicial process to present its position fully.

Id. That is, B's subsequent security interest for \$4000 is avoided and preserved by the bankruptcy trustee, but the debtor can, in turn, avoid this security interest under § 522(f)(1)(B), since it is not purchase money. 11 U.S.C. § 522(g) (1994). Meanwhile, A's lien can also be avoided under § 522(f)(1)(B). Thus, the debtor cannot help but benefit from squeeze-outs under the new definition of impairment under § 522(f)(2).

FN144 Cross, *supra* note 140, at 323–25. The chronological approach is loosely analogous to § 724(b), the section that governs the circular priority of the trustee's administrative expenses, which are senior to a tax lien, which is senior to any junior lien, which is senior to the trustee's administrative expenses. See 11 U.S.C. § 724(b) (1994). In the above scenario, A's senior-but-avoided lien takes the place of the tax lien that is subordinated to the trustee's expenses. The debtor takes the place of the trustee.

First, only \$350 of A's security interest is void, and so \$250 of it is good. The first distribution, therefore, is to A's valid secured claim of \$250. See *In re Shafner*, 165 B.R. 660, 662 (Bankr. D. Colo. 1994) (Cordova, J.). This leaves \$1200 to distribute the amount of the debtor's exemption. Next, take A's remaining claim of \$350 out of the proceeds, but do not give it to A, because this part of A's security interest has been avoided under § 522(f)(1)(B). Rather, give it to the debtor, to the extent of the exemption. 11 U.S.C. § 724(b)(2) (1994); see *In re Rader*, 144 B.R. 864 (Bankr. W.D. Mo. 1992). Since the debtor's exemption is for \$1200, this exhausts the subfund of \$250 that would have gone to A but for lien avoidance. B cannot complain so far; all that we have done is to honor A's priority over B. Meanwhile, we have \$850 left to distribute.

At this point, the valid part of A's secured claim has been paid, and the invalid part has been given to the debtor. Next, B has full priority to these remaining proceeds. See 11 U.S.C. § 724(b)(4) (1994). On our numbers, B takes the entire \$850, which exhausts the fund.

FN145 See *Silver v. Savings Bank (In re Fiore)*, 27 B.R. 48, 50 (Bankr. D. Conn. 1983) (Krechevsky, J.) (holding creditor's judicial lien not avoidable since at time lien attached it did not impair any potential exemption).

FN146 Waiver was based on the complaint that, under either of the above distributive systems, the debtor walked away with an exemption (\$350 worth or \$600 worth respectively) when the junior purchase money secured party had not yet been paid. Following this instinct, some courts, prior to 1994, blocked the debtor by insisting that, to the extent valid junior security interests were created on exempt property, the debtor "waived" the right to avoid senior liens. *Saturley v. Casco N. Bank (In re Saturley)*, 149 B.R. 245, 248–49 (Bankr. D. Me. 1993) (Haines, J.); *In re Murray*, 105 B.R. 576, 583 (Bankr. C.D. Cal. 1989) (Goldberg, J.); *In re Baldwin*, 84 B.R. 394, 396 (Bankr. W.D. Pa. 1988) (Bentz, J.). The *Baldwin* court noted that "when the debtor consents to the most subordinate mortgage on his property, he ratifies, by his consent, all of the prior [avoidable] liens then in existence on that property." *Id.* at 399.

According to this approach, B's claim for \$4000 means that the debtor has no right to avoid A's senior security interest. As a result, A's lien is entirely valid and, incidentally, still senior to B. In other words, A benefits because the debtor

conveyed all equity to *B*.

The waiver approach is in essence an application of the policy embodied in § 522(g)(1). 11 U.S.C. § 522(g)(1) (1994). Section 522(g) indicates that if the debtor has voluntarily conveyed exempt property away and the trustee later recovers it under § 550(a), the trustee may keep it for the general creditors because the debtor has forfeited the exemption by proving that it was never really necessary for the debtor's fresh start after bankruptcy. *Id.*; *cf. In re Audey*, 66 B.R. 52, 53 (Bankr. W.D. Pa. 1986) (Cosetti, J.) (refusing to follow waiver theory because *B*'s lien was not a voluntary conveyance but an involuntary tax lien).

Notice that, thanks to § 522(g)(2), this waiver idea does not apply if the debtor can avoid the security interest under § 522(f)(1)(B). 11 U.S.C. § 522(g)(2) (1994). This cross-reference to § 522(f)(1)(B) indicates that the waiver approach cannot be applied to any case involving an Article 9 security interest on the personal property described in § 522(f)(1)(B). *See id.* Additionally, the waiver approach ignores the opening clause of § 522(f), which states that the debtor's avoidance power is "[n]otwithstanding any waiver of exemptions." *Id.* § 522(f). This suggests that the debtor can encumber her equity in exempt property without adverse consequences to the avoidance power, contrary to the cases following the waiver approach.

FN147 11 U.S.C. § 522(f)(1) (1994).

FN148 *Id.* § 522(f)(3).

FN149 *Id.*

FN150 *See id.* § 522(f)(1)(B)(i)–(ii). This reasoning arises based upon the limitation contained in subsection (i), that limits the exemption to crops for "personal, family, or household use." *Id.*

FN151 *Id.* § 522(f)(3).

FN152 *See* 11 U.S.C. § 522(f)(1) (1994) (indicating debtor's property being used by dependant is outside reach of lien avoidance).

FN153 *Id.* § 522(f)(1)(B)(i)–(ii).

FN154 *Id.* § 522(f)(3)(A)–(B).

FN155 *Id.* § 522(f)(3)(A).

FN156 At present thirty–six states have opted–out of the federal exemptions. *E.g.*, CAL. CIV. PROC. CODE § 703.130 (West 1987); N.Y. DEBT. & CRED. LAW § 282 (McKinney 1984); IOWA CODE ANN. § 627.10 (West Supp. 1995).

FN157 Fourteen states have not opted–out of the federal exemptions contained in § 522(d). *See supra* note 156; *see also In re Zimmer*, 185 B.R. 786, 791 n.3 (Bankr. D. Minn. 1995) (O'Brien, J.) (indicating that thirty–five states have opted out of Bankruptcy Code exemptions).

FN158 11 U.S.C. § 522(f)(3)(A) (1994).

FN159 *Id.* § 522(e).

FN160 *See In re Parrish*, 186 B.R. 246, 247 (Bankr. W.D. Wis. 1995) (Martin, J.) (indicating that § 522(f)(3) limit only applies if debtor chooses state law exemptions).

FN161 *See* 11 U.S.C. § 522(f)(3) (1994).

FN162 *Parrish*, 186 B.R. at 247 (finding § 522(f)(3)(A) met when debtor chooses state exemptions).

FN163 140 CONG. REC. H10,752, H10,770 (daily ed. Oct. 4, 1995).

FN164 185 B.R. 786 (Bankr. D. Minn. 1995) (O'Brien, J.).

FN165 *Id.* at 791.

FN166 *See id.* (indicating that plain meaning points toward no limitation where there is access to federal exemptions).

FN167 11 U.S.C. § 522(f)(3)(B) (1994).

FN168 *Id.*

FN169 *Id.*; *Zimmel*, 185 B.R. at 791.

FN170 LA. REV. STAT. ANN. § 13:3881(B)(2) (West 1991).

FN171 TEX. PROP. CODE ANN. § 42.002(b) (West 1984 & Supp. 1996).

FN172 WIS. STAT. ANN. § 815.18(12) (West 1994); *see also In re Parrish*, 186 B.R. 246, 246 (Bankr. W.D. Wis. 1995) (Martin, J.) (finding that Wisconsin exemption law satisfies § 522(f)(3)(B)).

FN173 *But see Zimmel*, 185 B.R. at 793 (finding that Minnesota exemption law does not satisfy second condition precedent).

FN174 *Everett*, *supra* note 68, at 1331.

FN175 H.R. REP. NO. 835, *supra* note 17, at 56–57, *reprinted in* 1994 U.S.C.C.A.N. at 3365–66.

FN176 *See Zimmel*, 185 B.R. at 793 (describing nature of Minnesota exemption law).

FN177 *Id.*

FN178 MINN. STAT. ANN. § 550.37 (West 1988 & Supp. 1996).

FN179 *Zimmel*, 185 B.R. at 795.

FN180 *Id.* Judge O'Brien tells the story of § 522(f)(3), which he refers to as the product of "special interest efforts." *Id.* at 793. According to this tale, Philip S. Corwin of the American Banking Association ordered up this amendment in order to reverse *Owen v. Owen* in Florida (the state that generated the litigation in *Owen*), Louisiana, and Texas (where two Fifth Circuit opinions had ruled in a manner adverse to the *Owen* rule). *Id.* at 793–94. Apparently, Corwin overlooked states like Minnesota, where exemption by monetary limits existed, but no affirmative prohibition of lien avoidance existed as a matter of state law. *Id.* Thus, even where Congress is entirely pliant and supine, the life of a lobbyist does not always run smoothly.

FN181 *See* 11 U.S.C. § 522(f)(3) (1994) (indicating that subsection (3) is a limitation on the avoidance permitted under subsection (1)).

FN182 *Id.*

FN183 *Id.*

FN184 *Id.*

FN185 See *In re Parrish*, 186 B.R. 246, 248 (Bankr. W.D. Wis. 1995) (Martin, J.) (applying § 522(f)(3) limitation once to single lien on two tractors).

FN186 See 11 U.S.C. § 522(f)(3) (1994) (using plural nouns to refer to subject classifications of property).

FN187 Accord *Parrish*, 186 B.R. at 248. *Parrish* applied the § 522(f) limit in the aggregate. *Id.* This could be compared to § 547(c)(8), under which transferees are given a \$600 exemption. 11 U.S.C. § 547(c)(8) (1994). Where the creditor has received several transfers, the issue arises whether the value of the items must be aggregated, or whether the secured party is protected for each transfer worth less than \$600. David Gray Carlson, *Security Interests in the Crucible of Voidable Preference Law*, 1995 U. ILL. L. REV. 211, 349–50. The better view is that aggregation is not permitted the opposite result suggested here with regard to § 522(f)(3). *Id.*

FN188 11 U.S.C. § 522(f)(3) (1994).

FN189 *Id.* § 522(f)(2); see *supra* notes 52–66 (discussing fully the § 522(f)(2) impairment formula).

FN190 11 U.S.C. § 522(f)(3) (1994).

FN191 Cf. *Parrish*, 186 B.R. at 248. In *Parrish*, tractors were claimed as exempt. Judge Robert Martin allowed for lien avoidance up to \$5000. He never assigned a value to the collateral, which § 522(f)(3) requires in order to perform the calculation described there.

FN192 See *Rainier Equip. Fin., Inc. v. Taylor (In re Taylor)*, 73 B.R. 149, 150–51 (Bankr. 9th Cir. 1987) (Ashland, J.) (dealing with avoidance of lien on \$52,000 logging truck), *aff'd*, 861 F.2d 550 (9th Cir. 1988) (Brunetti, J.).

FN193 11 U.S.C. § 522(f)(2) (1994).

FN194 *Id.* § 522(f)(2)(A)(i)–(iii).

FN195 *Id.* § 522(f)(2)(A).

FN196 *Id.* § 522(f)(3).

FN197 Accord *Everett*, *supra* note 68, at 1352; cf. Ned W. Waxman, *The Bankruptcy Reform Act of 1994*, 11 BANKR. DEV. J. 311, 325 (1995). Professor Waxman describes § 522(f)(3) as creating "a ceiling of \$5000 on the avoidance of a nonpossessory nonpurchase– money security interest." *Id.* His formulation is not precisely accurate, however. In the above example, lien avoidance equalled \$55,000, well above the supposed \$5000 ceiling he attributes to § 522(f)(3).

FN198 11 U.S.C. § 522(f)(2)(A)(i)–(iii) (1994).

FN199 *Id.* § 522(f)(2)(A).

FN200 *Id.* § 522(f)(3).

FN201 *Everett*, *supra* note 68, at 1354.

FN202 *Id.*

FN203 *Everett*, *supra* note 68, at 1354.

FN204 11 U.S.C. § 522(d)(6) (1994).

FN205 TEX. PROP. CODE ANN. § 42.001–.002 (West 1984 & Supp. 1996).

FN206 11 U.S.C. § 522(f)(3) (1994); *see also* Everett, *supra* note 68, at 1356.

FN207 Everett, *supra* note 68, at 1356.

FN208 *See supra* part III.A (discussing conditions precedent to application of § 522(f)(3)).

FN209 *Id.*

FN210 *See supra* text accompanying notes 177–180.

FN211 *In re* Zimmel, 185 B.R. 786, 788–89 (Bankr. D. Minn. 1995) (O'Brien, J.).

FN212 11 U.S.C. § 522(f)(2)(A)(i)–(iii) (1994).

FN213 *Id.* § 522(f)(2)(A).

FN214 *Id.* § 522(f)(3)

FN215 *See* Everett, *supra* note 68, at 1351–52 (discussing similar example).

FN216 *See supra* text accompanying notes 185–187.

FN217 11 U.S.C. § 522(f)(2)(A)(i)–(iii) (1994).

FN218 *Id.* § 522(f)(2)(A).

FN219 *Id.* § 522(f)(3).

FN220 *Id.* § 522(f)(2)(A)(i)–(iii).

FN221 *Id.* § 522(f)(2)(A).

FN222 11 U.S.C. § 522(f)(3) (1994).