In re Blair Misses the Mark: An Alternative Interpretation of the BAPCPA's Homestead Exemption*

I. INTRODUCTION

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)[1] implemented the most substantial revision to American bankruptcy law in nearly three decades.[2] The BAPCPA's main effect is

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1. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified at 11 U.S.C.).

2. Prior to the BAPCPA, the Bankruptcy Code had not seen a major revision since the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C.). *See* Rodney Tanaka, *New Bankruptcy Laws Aren't That Bad*, INLAND VALLEY DAILY BULL., Jan. 4, 2006 (noting that the BAPCPA is the most drastic revision of American bankruptcy law since the late 1800s), *available at* http://blog.startfreshtoday.com/archives/162-print.html.

to improve the position of creditors, both secured and unsecured, and impose greater personal accountability on individuals who file for bankruptcy—debtors.[3] Although the name "Consumer Protection Act" suggests a law whose goal is to foster humanitarian treatment of debtors and further rehabilitation, commentators generally view the BAPCPA as anything but pro-debtor.[4] Many have referred to the BAPCPA as the best bankruptcy act money can buy.[5] If the slant of the BAPCPA is indeed the result of effective lobbying, it was the lobbying power of creditors, not debtors, that influenced Congress.[6]

Bankruptcy law is wrought with compelling policy tensions, which legislators, judges, and academics must constantly balance. Bankruptcy law seeks to foster a "fresh start" and promote the rehabilitation of distressed debtors discharged from bankruptcy,[7] while simultaneously

3. While the term *debtors* ordinarily refers to any person or entity liable to another person or entity, this Note will use the term to refer specifically to individuals or entities that file for bankruptcy relief.

4. *See, e.g.*, Jean Braucher, *Rash and Ride-Through Redux: The Terms for Holding on to Cars, Homes and Other Collateral Under the 2005 Act*, 13 AM. BANKR. INST. L. REV. 457, 457 n.3 (2005) (noting that some academics refuse to refer to the BAPCPA by using its proper name because of the Act's "dubious policy choices"); Robert J. Keach, *Dead Man Filing Redux: Is the New Individual Chapter Eleven Unconstitutional?*, AM. BANKR. INST. L. REV., 483, 500-02 (2005) (discussing whether amendments to Chapter 11 go so far as to constitute involuntary servitude in violation of the Thirteenth Amendment).

5. *See, e.g.*, Braucher, *supra* note 4, at 457 (discussing "what can go wrong when an interest group uses its muscle to pass a complex piece of legislation").

6. It is unlikely that debtors would be able to fund significant lobbying efforts for a number of reasons. First, individuals who enter bankruptcy do not have the type of disposable income necessary to contribute to political causes. Second, debtors typically interact less frequently with the bankruptcy system than do creditors. Debtors are prohibited from frequently filing for bankruptcy, thus they have minimal incentives to expend resources in attempts to modify bankruptcy laws. Conversely, certain creditors, including those whose businesses revolve around extending credit to consumers, routinely interact with the bankruptcy systems. Because certain creditors routinely participate in bankruptcy proceedings, it is in their best interest to expend resources in efforts to reform the bankruptcy laws. Thus, it is not surprising that creditors exert more influence over Congress than debtors.

7. The fresh start policy allows the debtor to retain certain personal and real property after discharge from bankruptcy:

> A fundamental component of an individual debtor's fresh start in bankruptcy is the debtor's ability to set aside certain property as exempt from the claims of creditors. Exemption of property, together with the discharge of claims, lets the debtor maintain an appropriate standard of living as he or she goes forward after the bankruptcy case.

4 COLLIER ON BANKRUPTCY ¶ 522.01 (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev. 2006) [hereinafter COLLIER ON BANKRUPTCY]. Rehabilitation facilitates the humanitarian goals of bankruptcy laws:

> The goal of debtor rehabilitation is, according to one commentary, accomplished in at least three ways. First, a collective process reduces costs associated with monitoring the debtor to protect the creditor from the race to the courthouse that occurs outside the bankruptcy process. Second, the interested parties are

ensuring that creditors receive repayment of debts owed to them by debtors.[8] When bankruptcy law focuses too heavily on paternalistic goals—providing a fresh start to debtors and fostering debtor rehabilitation—both creditors and consumers suffer financially.[9] Every dollar that remains with the debtor in furtherance of a fresh start is a dollar removed from the bankruptcy estate, and thus, a dollar that cannot go to repayment of debt.[10] This Note addresses this central policy tension as it relates to the revised homestead exemption under the BAPCPA.

Part II of this Note introduces the reader to the basics of exemption law and some of the major changes implemented by the BAPCPA. Of particular importance in Part II is the creation of a $125,000 cap on all interest acquired by the debtor in her homestead within the 1215 days preceding filing for bankruptcy.[11] Part III then describes *In re Blair*,[12] a case which considered whether equity acquired by way of appreciation or mortgage payments within the 1215-day period is subject to the

> benefited by the administrative efficiencies of a collective proceeding. Third, a collective proceeding is likely to increase the aggregate pool of assets by prohibiting a disadvantageous, piecemeal liquidation of the debtor's assets.

9 AM. JUR. 2D *Bankruptcy* § 2 (1999) (citing *Bankruptcy for Nonbankruptcy Purposes: Are There Any Limits?*, 6 REV. LITIG. 95 (1987)).

8. The reader should not lose sight of the fact that bankruptcy law is not designed as a means to allow debtors to shirk their responsibilities. Instead, bankruptcy law seeks to foster the proper balance between humane treatment of the debtor and adequate repayment of debts owed:

> In terms of societal function, the law of bankruptcy embodies two competing policy considerations: providing a fresh start to debtors and protecting the rights of creditors. The fresh start policy is designed both to relieve the honest debtor of the burden of repaying insurmountable debts and to provide him with enough assets to resume a productive life as a responsible, contributing, debt-paying member of society. Bankruptcy also seeks to protect creditors by arranging the orderly repayment of debts. The Bankruptcy Code provides for creditor protection by gathering all of the debtor's property and placing it into a central estate, automatically staying all collection efforts to prevent aggressive creditors from devouring the estate, and providing an opportunity for all creditors to be treated fairly and have their claims repaid in an organized, predictable manner.

Ryan J. Donohue, *Thou Shalt Not Reorganize: Sacraments for Sale, First Amendment Prohibitions and Other Complications of Chapter 11 Reorganization for Religious Institutions*, 22 EMORY BANKR. DEV. J. 293, 302 (2005) (citations omitted).

9. For example, if the bankruptcy laws prohibited recovery of more than fifty percent by any credit card company, two arguably negative results would follow: credit card companies would be less willing to extend credit and credit card companies would likely increase the rates they charge cardholders and merchants.

10. The bankruptcy estate is essentially the pool of assets used to pay creditors.

11. 11 U.S.C. § 522(p) (2000 & West. Supp. 2005).

12. 334 B.R. 374 (N.D. Tex. 2005).

aforementioned cap.[13] The *Blair* court held that the cap on homestead exemptions does not apply to debtors who acquire title more than 1215 days before filing a bankruptcy petition, regardless of whether the debtors acquire equity during the 1215-day period.[14] Finally, Part IV proposes an alternative interpretation of the revised homestead cap. This proposal, unlike the conclusion reached by the *Blair* court, is consistent with the goals of the BAPCPA because it increases the size of many bankruptcy estates and promotes fairness to creditors.[15]

II. THE BAPCPA

President George W. Bush signed the BAPCPA into law on April 20, 2005.[16] While the majority of the provisions did not become effective until October 17, 2005, certain provisions, including the cap on homestead exemptions, became effective immediately.[17] The BAPCPA's major provisions benefit creditors at the expense of debtors.[18] Congress made a clear policy choice when drafting the BAPCPA: bankruptcy law had become too paternalistic and needed substantial pro-creditor revision.[19] Congress sought to prevent abuse of the bankruptcy system, discouraging consumers from filing bankruptcy and encouraging those debtors who do file bankruptcy petitions into repayment plans under Chapter 13.

The revisions to § 707(b) of the Code exemplify the pro-creditor revisions under the BAPCPA.[20] Under § 707(b), a debtor's case will be dismissed from Chapter 7 or converted to Chapter 13 upon a finding that the debtor has abused the bankruptcy system.[21] Abuse occurs when the

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13. *See id.* at 375.

14. *See id.* at 376-77.

15. The size of a bankruptcy estate can be measured by subtracting the debtor's exemptions from the debtor's assets. The proposed rule will increase the size of many bankruptcy estates by reducing the size of debtor's exemptions. Part IV, *infra*, provides a number of examples which illustrate this principle. Larger bankruptcy estates benefit creditors because they increase the amount which creditors will recover.

16. WILLIAM HOUSTON BROWN & LAWRENCE R. AHERN III, 2005 BANKRUPTCY REFORM LEGISLATION WITH ANALYSIS 11 (2005).

17. *Id.* ("Although several specific provisions of BAPCPA are effective immediately upon enactment or at other times specified, the bulk of BAPCPA amendments and additions to the former Code are effective in cases filed 180 days after enactment. The 180 days from the President's signing would be October 17, 2005.").

18. *See* 11 U.S.C. § 362 (2000 & West. Supp. 2005) (imposing numerous additional limitations on the protection afforded debtors through the automatic stay); § 521(a)(6) (removing the protection of the automatic stay when the debtor fails to take certain actions); § 707(b) (creating the "means test" for Chapter 7 eligibility); § 1322(d) (extending the length of typical Chapter 13 plans to five years).

19. *See* H.R. REP. NO. 109-31 at 3-5 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 89-92.

20. § 707(b).

21. *Id.*

debtor either (a) fails the means test and fails to rebut the presumption of bad faith; or (b) exhibits general grounds for bad faith.[22] A consumer debtor fails the means test if a court determines that the debtor has more than $167 in monthly income under the provision's long and complicated formula.[23] A debtor who fails the means test may only remain in Chapter 7 upon a rebuttal of the presumption of bad faith.[24] In order to rebut the presumption of bad faith, the debtor must attest to "special circumstances" that adjust the debtor's monthly income below the threshold amounts.[25] Debtors typically prefer Chapter 7 to Chapter 13 because Chapter 7 provides a quicker discharge of the debtor's obligations.[26] However, because many debtors cannot prove special circumstances, the means test is likely to reduce the number of debtors who qualify for Chapter 7 substantially. The means test embodies the pro-creditor purpose of the BAPCPA.[27]

The most controversial exemption in the Bankruptcy Code prior to the passage of the BAPCPA was the homestead exemption. A bankruptcy estate commences when a debtor files for bankruptcy or when an involuntary case is commenced against the debtor.[28] The estate is "defined broadly

22. *Id*.
23. *Id.*; Marianne B. Culhane & Michaela M. White, *Catching Can-Pay Debtors: Is the Means Test the Only Way?*, 13 AM. BANKR. INST. L. REV. 665, 665 (2005) (noting further that for some debtors the threshold income amount is as little as $100 of income per month).
24. § 707(b).
25. There are a number of ways to establish special circumstances:

> In any proceeding brought under this subsection, the presumption of abuse may only be rebutted by demonstrating special circumstances, such as a serious medical condition or a call or order to active duty in the Armed Forces, to the extent such special circumstances that justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative.

§ 707(b)(2)(B).
26. *See* 1 ROSEMARY E. WILLIAMS, BANKRUPTCY PRACTICE HANDBOOK § 5:99 (2d. ed. 2005) (noting that the Chapter 7 debtor receives a discharge in significantly less time than the Chapter 13 debtor).
27. The means test is advantageous to creditors because it removes certain debtors from bankruptcy. When a debtor is removed from bankruptcy the debtor is obligated to pay the entire amount owed to each creditor. Conversely, a debtor who remains in the bankruptcy system may be discharged despite only repaying a small portion of what was owed to creditors. A debtor removed from bankruptcy for failing the means test will have to repay his or her debts in their entirety. Thus, the means test favors creditors by forcing certain debtors to repay their entire debt, instead of a small portion of their debt.
28. *See* 9 AM. JUR. 2D *Bankruptcy* § 1083 (1999).

to include all legal and equitable interests of the debtor."[29] However, the debtor may claim certain property as exempt from the bankruptcy proceeding.[30] Consistent with the fresh start policy behind the Code, the debtor retains exempt property after discharge from bankruptcy.[31] Prior to the BAPCPA, a small number of states provided debtors with unlimited homestead exemptions,[32] which allowed debtors to protect their assets from creditors prior to filing bankruptcy.[33] Debtors could abuse an unlimited homestead exemption by selling nonexempt assets and investing the proceeds in a homestead.[34] By engaging in pre-bankruptcy planning, debtors were able to increase the portion of their assets which were exempt from the bankruptcy estate. Some debtors went so far as to relocate to states with unlimited homestead exemptions and acquire lavish homes

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29. COLLIER ON BANKRUPTCY, *supra* note 7, at Intro.01. The broad definition of the bankruptcy estate brings in as many assets and interests as possible:

> With certain limited exceptions, the initial pool of assets which forms the estate created upon the commencement of a bankruptcy case consists of all legal or equitable interests of the debtor in property as of the commencement of the case, wherever located and by whomever held. The scope of the bankruptcy estate formed upon the commencement of a bankruptcy case has thus been described as sweeping, in that virtually all of the debtor's interests in property existing as of case commencement are automatically included in the estate.

9 AM. JUR. 2D *Bankruptcy* § 1084 (citations omitted).

30. *See* 9 AM. JUR. 2D *Bankruptcy* § 1245.

31. Exempt property under the respective chapters of the Bankruptcy Code is property which the debtor may retain after discharge from bankruptcy:

> In cases under Chapter 7, exempt property is that property which the debtor will retain and which cannot be seized by the trustee for sale and distribution to creditors. . . . In cases under Chapter 11, the individual debtor may withhold exempt property from disposition under a plan of arrangement with creditors.

See WILLIAMS, *supra* note 26, at § 4:6. The Code allows states to forbid their citizens from using the federal exemptions listed in § 522. *See* 11 U.S.C. § 522(b) (2000 & West. Supp. 2005). Thirty-four states, including New York and California, have opted out of the federal exemptions scheme. COLLIER ON BANKRUPTCY, *supra* note 7, at ¶ 522.01. In states that have not opted out of the federal scheme, debtors are free to elect either the federal exemptions scheme or the state exemption scheme in the debtor's state of domicile. *See* § 522(b).

32. *See* Daniel Morman, *Judgment Liens, Homestead Exemptions and Involuntary Bankruptcies: Who Gets What After BAPCPA*, 24 AM. BANKR. INST. J. 20, 20 (2005) ("Many states provide for homestead exemptions to some degree. However, while Florida garners all the fame and glory for its unlimited homestead, [sic] exemption, four other states—Texas, Iowa, Kansas and South Dakota—have unlimited homestead exemptions as well.").

33. *See* H.R. REP. NO. 109-31 at 15-16 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 101-02.

34. *See id.*

in order to protect their assets from creditors.[35] For this reason, many termed the exemption the "mansion loophole."[36]

The mansion loophole garnered substantial attention during the drafting of the BAPCPA.[37] Congress reformed the homestead exemption by adding § 522(p) to the Code in an effort to curb the bankruptcy system abuse afforded by the mansion loophole.[38] Section 522(p) prevents a debtor from claiming as exempt "any amount of interest that was acquired by the debtor during the 1215-day period preceding the date of the filing of the petition that exceeds in the aggregate $125,000 in value in [real property used as a residence or homestead]."[39] Unfortunately, Congress did not define "interest that was acquired" or sufficiently explain how the § 522(p) cap should be applied. These drafting shortcomings lead to the controversy presented in *Blair*.[40]

III. *IN RE BLAIR*

In May 2005, Kevin Edward Blair and Susan Robin Blair (the Blairs) filed a voluntary Chapter 7 bankruptcy petition.[41] The Blairs elected to utilize Texas state exemptions instead of federal exemptions.[42] Before the BAPCPA, the Blairs would have been entitled to an unlimited homestead exemption under the Texas exemption scheme.[43] The Blairs

35. *Id.*

36. *See, e.g.*, Margaret Howard, *Exemptions Under the 2005 Bankruptcy Amendments: A Tale of Opportunity Lost*, 79 AM. BANKR. L.J. 397, 402 (2005). The mansion loophole drew unwelcome attention when it became public in July of 2002 that former WorldCom CFO Scott D. Sullivan was building a $15 million mansion in Boca Raton Florida that might qualify for the homestead exemption. Barry A. Nelson & Kevin E. Packman, *Florida's Unlimited Homestead Exemption Does Have* Some *Limits*, 78 FLA. B.J. 60, 60 (2003).

37. *See* H.R. REP. NO. 109-31 at 15-16.

38. *See id.* (categorizing the amended homestead exemptions as a reform intended to curb abuse of the bankruptcy system and noting that the bill sought to restrict the mansion loophole).

39. 11 U.S.C. § 522(p) (2000 & West. Supp. 2005).

40. *In re* Blair, 334 B.R. 374, 375 (N.D. Tex. 2005).

41. *Id.*

42. *Id.* For a list of the federal exemptions, see § 522.

43. *See* Morman, *supra* note 32, at 20. Subsequent to passage of the BAPCPA, courts disagree whether the § 522(p) cap applies to debtors who elect state exemption schemes. *Compare In re* McNabb, 326 B.R. 785, 791 (Bankr. D. Ariz. 2005) (holding that the § 522(p) cap is not applicable to debtors who reside in states that do not allow debtors to chose between federal and state exemptions), *with In re* Kaplan, 331 B.R. 483, 488 (Bankr. S.D. Fla. 2005) (relying on the silence of legislative history in holding that

claimed a homestead exemption of $688,606, which represented the entire equity interest in their home.[44]

Southwest Security Bank (SSB), an unsecured creditor, filed an objection to the Blairs' claimed homestead exemption.[45] Citing § 522(p), SSB objected to "any and all interest that the Debtors acquired between January 27, 2002 (1215 days prior to the Petition Date) and the Petition Date which exceeds $125,000. . . ."[46] SSB's objection presented a novel question for the court: whether the $125,000 cap on homestead exemptions applies to debtors who acquire title to real property outside the 1215-day period but continue to accumulate equity during the period.[47]

The *Blair* court held that the 522(p) cap did not apply to the Blairs because they acquired title to their home outside of the 1215-day period.[48] The court drew a puzzling distinction between equity and title.[49] According to the *Blair* court's reasoning, "one does not actually 'acquire' equity in a home. One acquires title to a home."[50] This distinction directly contradicts the contemporary understanding of the term *equity*. *Equity* is defined as, "[i]n the context of real estate, the difference between the current market value of the property and the amount the owner still owes on the mortgage. Thus, it is the amount, if any, the owner would receive after selling a property and paying off the mortgage."[51] Equity in the real estate market is something homeowners acquire over time.[52]

The *Blair* court premised its holding on a fatal misunderstanding of the phrase "interest that was acquired" as used in the homestead exemption cap. In holding that the 522(p) cap does not apply to debtors who acquire title more than 1215 days prior to filing for bankruptcy, the court incorrectly interpreted the phrase to refer to the acquisition of *title*.[53] Rather, "interest that was acquired" likely refers to the acquisition of *equity*. It is hard to believe that Congress intended to provide that the 522(p) does not apply to equity acquired during the 1215 days before a debtor files a bankruptcy petition, as the *Blair* court held. Such an

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the § 522(p) cap is applicable to all debtors regardless of whether the debtors are allowed to choose federal exemptions under state law).

44. *Blair*, 334 B.R. at 375.
45. *Id.*
46. *Id.*
47. *Id.*
48. *Id.* at 376-78.
49. *See id.* at 376.
50. *Id.*
51. INVESTOPEDIA FINANCIAL DICTIONARY, http://www.investopedia.com/terms/e/equity.asp (last visited Dec. 20, 2006).
52. A homeowner who holds title to her home but owes more than the current market value has no equity.
53. *See Blair*, 334 B.R. at 376.

interpretation of the homestead exemption cap is contrary to the pro-creditor purpose which defines the BAPCPA and the exemption itself.[54]

The *Blair* court bolstered its erroneous holding by noting that its interpretation of the § 522(p) cap was "consistent with the companion provision in § 522(p) added by the BAPCPA."[55] Section 522(p)(2)(B), the companion provision to which the *Blair* court referred, provides an exception to the $125,000 cap on interest acquired for any interest transferred from a previous primary residence within the same state. "[A]ny amount of such interest does not include any interest transferred from a debtor's previous principal residence (which was acquired prior to the beginning of such 1215-day period) into the debtor's current principal residence, if the debtor's previous and current residences are located in the same State."[56]

Contrary to the court's assertion, this § 522(p)(2)(B) companion provision does nothing to support the assumption that "interest" in § 522(p) refers to title rather than equity. In fact, the *Blair* court's distinction between title and equity is weakened by its own interpretation of the companion provision. The court summarized the companion provision as follows: "this subsection allows for rollover by debtors of the *equity* in one home to another home located in the same state."[57] The *Blair* court inexplicably interpreted *interest* to mean *title* in § 522(p)(1),[58] while interpreting it to mean *equity* in § 522(p)(2)(B).[59]

A consistent interpretation requires that the term *interest* refer to either title or equity throughout § 522(p). Interpreting *interest* to refer to title would make § 522(p)(2)(B) incomprehensible, since one cannot transfer title from one home to another home. Thus, although interpreting *interest* to

54. The Purpose and Summary section of the legislative history outlines the policy objectives Congress sought to achieve with the BAPCPA. The House Report lists the goals of the BAPCPA as increasing personal financial accountability, preventing "the proliferation of serial filings," and implementation of a means test "which is intended to *ensure that debtors repay creditors the maximum they can afford*." H.R. REP. NO. 109-31 at 2, *reprinted in* 2005 U.S.C.C.A.N. at 89 (emphasis added). The legislative history of the BAPCPA strongly suggests that the homestead exemption focuses on acquisition of equity rather than acquisition of title. *See id.* ("[T]he bill caps the amount of homestead equity a debtor may shield from creditors, under certain circumstances.").

55. *Blair*, 334 B.R. at 377.

56. 11 U.S.C. § 522(p)(2)(B) (2000 & West. Supp. 2005).

57. *Blair*, 334 B.R. at 377 (emphasis added). That the companion provision refers to equity undermines the *Blair* court's interpretation of "interest that was acquired."

58. *See id.*

59. *See id.*

refer to equity throughout § 522(p) would invalidate the *Blair* rule, it would be consistent with the *Blair* court's logical interpretation of 522(p)(2)(B).

The *Blair* court further attempted to strengthen its holding by citing a number of recent bankruptcy cases, which are all in fact distinguishable from the *Blair* decision.[60] First, the *Blair* court quoted *In re Virissimo*, where the Bankruptcy Court for the District of Nevada said that "[t]he monetary cap applies if the debtor acquired such property within the 1215-day period preceding the filing of the petition."[61] However, the preceding quotation does not necessarily support the *Blair* court's distinction between title and equity. The *Virissimo* court's statement would hold true regardless of whether "interest" in § 522(p) referred to title or equity. Furthermore, the quotation does not say—as the *Blair* court contends—that the monetary cap *only* applies to homes acquired within 1215 days prior to filing the bankruptcy petition.[62]

The strongest support for the *Blair* court's decision comes from its citation of *Collier on Bankruptcy*.[63] *Collier* proposed that the homestead exemption cap should not apply to any amount of interest which results from appreciation or regularly scheduled mortgage payments.[64] But although *Collier* supports the *Blair* court's holding that appreciation and regular mortgage payments are not subject to the homestead exemption cap, *Collier* does not support the court's distinction between title and equity. Instead, *Collier* understands the term *interest* within the meaning of § 522(p) to refer to equity rather than title.[65] *Collier* further implies that the portion of debtor's equity attributable to mortgage payments in excess of those regularly scheduled should be subject to the homestead exemption cap.[66]

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60. *See id.* at 377.
61. *Id.* (citing *In re* Virissimo, 332 B.R. 201, 207 (Bankr. D. Nev. 2005)).
62. *See id.*
63. *Id.* (citing COLLIER ON BANKRUPTCY, *supra* note 7, at ¶ 522.13[2]).
64. According to the *Collier* proposal:

> Under this view, section 522(p) should not apply to any amount of interest in the debtor's homestead that is acquired through no affirmative action of the debtor, such as an appreciation in the homestead's value resulting solely from changes in the real estate market during the 1215-day period. Similarly, this provision should not prevent the debtor from claiming as fully exempt any increase in the debtor's equity interest in a homestead attributable to the application of regularly scheduled mortgage payments during the 1215-day period.

COLLIER ON BANKRUPTCY, *supra* note 7, at ¶ 522.13[2].

65. *Id.* (discussing which types of equity should not be subject to the homestead exemption cap).
66. *See id.*

Collier bases its proposal—that the homestead exemption cap should not apply to interest resulting from appreciation or regularly scheduled mortgage payments—on the assumption that the purpose of § 522(p) is to prevent debtors from engaging in egregious pre-bankruptcy planning.[67] *Collier* ignores the possibility that the homestead exemption cap is an integral part of a larger congressional scheme intended to shift the balance of power in bankruptcy proceedings in favor of creditors.[68] *Collier's* proposal frustrates the purpose of the BAPCPA because it fails to increase the size of the bankruptcy estate and is therefore unfair to creditors. Moreover, other sections of the Code address the problem of abusive pre-bankruptcy planning.[69] Section 522(p) need not serve as a proxy for the anti-fraud provisions of the Code, as *Collier* suggests. A proper reading of the homestead exemption cap should increase the size of bankruptcy estates and thus foster fairness to creditors, consistent with the purpose behind the BAPCPA.

An alternative interpretation to *Collier's* and the *Blair* court's interpretations of the homestead exemption cap is presented below. This alternative interpretation fosters fairness to creditors while allowing debtors to leave bankruptcy with ample liquid assets. The proposal permits debtors to leave bankruptcy with liquid assets in an attempt to further the humanitarian goals of bankruptcy law. The below proposal is more consistent with congressional intent than the *Blair* court's interpretation of the § 522(p) cap (the *Blair* rule) because it reflects Congress's intent to shift the balance of bankruptcy law in favor of creditors.

IV. AN ALTERNATIVE INTERPRETATION: THE 522(P) EXEMPTION SHOULD APPLY TO EQUITY ACQUIRED DURING THE 1215-DAY PERIOD

Future bankruptcy courts should not follow the holding of *In re Blair*. Instead, they should apply the § 522(p) cap to equity acquired by the debtor during the 1215-day period. Thus, a debtor's homestead

67. *See id.*

68. A purposivist reading of § 522(p) would suggest that the provision should be read consistently with the crux of the BAPCPA. Thus, the homestead exemption cap should be interpreted in a manner that prevents hyper-paternalistic treatment of debtors and fosters fairness to creditors. For a discussion of the ongoing war between purposivism and textualism, see Jonathan T. Molot, *The Rise and Fall of Textualism*, 106 COLUM. L. REV. 1 (2006).

69. *See, e.g.*, 11 U.S.C. § 707(b) (2000) (providing for dismissal of bad faith filings).

exemption should equal the debtor's equity interest in the homestead 1216 days before filing for bankruptcy plus up to $125,000 of equity acquired during the 1215 days before filing. The below examples illustrate the significant difference between this proposed rule and the *Blair* rule.

Assume debtor Alpha closed on the purchase of a principal residence on day one. At closing, Alpha transferred $20,000 to sellers and assumed liability for a $180,000 mortgage. Alpha continued to make regular mortgage payments, but filed a bankruptcy petition on day 1216. As of day 1216, Alpha had made forty mortgage payments totaling $250,000, of which $150,000 was attributable to repayment of principal.[70]

Assuming for the moment that the home's value remained constant from day one to day 1216, the proposed rule and the *Blair* rule would produce similar results. Under the *Blair* rule, Alpha would not be subject to the § 522(p) cap. Thus, assuming the value of Alpha's home remained constant, Alpha would walk away from bankruptcy with an unreduced $170,000 interest in his $200,000 home under the *Blair* rule.[71]

The proposed rule differs from the *Blair* rule in that the proposed rule would result in larger bankruptcy estates in many bankruptcy proceedings. A bankruptcy estate is the total pool of a debtor's interests which are available to repay the debtor's debts.[72] The size of a bankruptcy estate can be calculated as follows: debtor's total assets minus debtor's exemptions. There is a positive correlation between the size of the bankruptcy estate and the amount creditors receive in bankruptcy. Increasing the size of bankruptcy estates is socially desirable because it fosters fairness to creditors. Increasing the amount of outstanding debt which is repaid to creditors prevents creditors from spreading the loss resulting from nonpayment by bankrupt debtors to other consumers. Thus, bankruptcy policies that favor repayment of debts ensure that non-defaulting consumers do not have to subsidize consumers who default on their debts.

Calculating the size of a § 522(p) exemption under the proposed rule is a two-step process. First, Alpha is entitled to an exemption for the entire equity interest that he possessed 1216 days before filing a bankruptcy petition. In this example, Alpha would have a $20,000 exemption, representing his interest in the home before the 1215-day period commenced. Second, Alpha is entitled to an exemption of up to $125,000 for acquisition of principal within the 1215-day period. In this

70. Alpha's payments exceed the value of the home because $100,000 of the $250,000 in payments is attributable to repayment of interest.

71. $170,000 is Alpha's equity interest in the home resulting from a $20,000 down payment plus $150,000 in mortgage payments attributable to repayment of principal.

72. *See supra* note 29.

example, Alpha made mortgage payments of $250,000 during the 1215-day period. Alpha should be entitled to claim an exemption on $125,000 of the $150,000 that was attributable to repayment of principal. Thus, Alpha's total homestead exemption under the proposed rule is $145,000.

In the previous example the proposed rule and the *Blair* rule produce comparable results. However, this is largely attributable to two unrealistic assumptions: that the home did not appreciate and that Alpha paid off nearly his entire mortgage prior to filing for bankruptcy. In a more realistic example, the discrepancy between the *Blair* rule and the proposed rule is likely to be far greater.[73] In recent years, the real property market enjoyed rapid appreciation.[74] The following example illustrates that in a hypothetical based on assumptions reflecting the upward trend in real estate value in the past few years, significant differences between the proposed rule and the *Blair* rule are likely to emerge.

Arguably, the greatest shortcoming of the *Blair* rule is that it fails to account for the value of any appreciation in the debtor's home. Assume Beta purchased a home on the same terms as Alpha. Unlike Alpha, Beta lived in a rapidly appreciating real estate market. Beta's home appreciated greatly between the closing date and the time Beta filed bankruptcy, consistent with trends in the local real estate market. In just 1215 days, Beta's home increased in value from $200,000 to $500,000. The *Blair* rule would yield the same result for Beta in this example as it did for Alpha in the first example: the debtors would be entitled to exemptions

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73. A more realistic example would include less repayment of Alpha's mortgage and some change in the value of Alpha's home. If, for example, Alpha only repaid $20,000 of his mortgage, the *Blair* rule and the proposed rule would result in substantially different results even if we still assume a static market value for the home. Under the proposed rule, Alpha would be entitled to an exemption totaling his equity interest in the home 1216 days before filing for bankruptcy, plus the portion of his mortgage payments attributable to repayment of principal. Assuming that one-half of Alpha's mortgage goes to repayment of principal, the proposed rule would provide Alpha with a $30,000 exemption. Thus, the likely result under the proposed rule would be the sale of Alpha's home. By contrast, under the *Blair* rule Alpha would be entitled to retain the home.

74. A recent article places the increase in real property values in the United States at 29% for a three-year period. Jon E. Hilsenrath & Patrick Barta, *Amid Low Rates, Home Prices Rise Across the Global Village*, WALL ST. J., June 16, 2005, at A1. Similar increases are becoming commonplace around the globe:

> Over the past three years, measures of housing values are up 48% in France, 63% in Spain and they've nearly doubled in South Africa, according to data gathered from these markets from sources including the Bank for International Settlements, Economy.com and The Wall Street Journal. In just the past year, prices have risen 19% in Hong Kong and 48% in Bulgaria.

Id.

for the entire value of their respective homesteads.[75] The greatest differences between the *Blair* rule and this Note's proposed rule will occur when the debtor makes significant repayment of principal or enjoys significant appreciation during the 1215-day period. This Note proposes that Beta is only entitled to a $145,000 homestead exemption.[76] Allowing Beta to retain her $500,000 homestead under the *Blair* rule defeats the central purpose of the BAPCPA.[77]

A particularly egregious result could occur under the *Blair* rule if Gamma purchased a home on the same terms as Alpha and Beta, but signed an interest-only mortgage.[78] Under the *Blair* rule, Gamma would be entitled to an exemption for the entire value of Gamma's homestead. If Gamma experienced the same appreciation as Beta, Gamma would walk out of bankruptcy with $320,000 in equity in his homestead despite investing only $20,000.[79] Allowing Gamma to benefit from this type of windfall is contrary to the purpose of the BAPCPA, since one of the goals of the BAPCPA is to "ensure that debtors repay creditors the maximum they can afford."[80] A debtor with over $300,000 in equity can surely afford to contribute some of her equity to the bankruptcy estate for the benefit of creditors. Under the proposed rule, Gamma would only be entitled to a $145,000 exemption. This exemption is the sum of Gamma's pre-1215-day period equity and the maximum of $125,000 in interest acquired during the 1215-day period.[81] In Gamma's case, the $125,000 is the product of appreciation and not mortgage payments.

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75. *See In re* Blair, 334 B.R. 374, 376-77 (N.D. Tex. 2005).

76. The $145,000 exemption is the sum of Beta's pre-1215-day period interest and a maximum $125,000 interest acquired during the 1215-day period.

77. *See supra* note 54.

78. The result under the *Blair* rule is egregious because the rule does not allow Gamma's creditors to benefit from the rapid appreciation Gamma experienced. Under the terms of an interest-only mortgage, the borrower is only required to pay interest. *See* Interest-Only Mortgage Tutorial, http://www.mtgprofessor.com/Tutorials2/InterestOnly.htm (last visited Dec. 20, 2006).

79. This $320,000 in equity results from subtracting Gamma's outstanding liability from the market value of the home. Because Gamma purchased the home for $200,000 and made an initial down payment of $20,000, her liability on the home was $180,000. Gamma's equity interest in the home is thus: $500,000 - $180,000 = $320,000.

80. H.R. REP. NO. 109-31 at 2, *reprinted in* 2005 U.S.C.C.A.N. at 89 (emphasis added).

81. The proposed rule does not differentiate between Beta and Gamma—one makes mortgage payments on principal due and the other merely benefits from appreciation—because the proposed rule recognizes the importance of incentivizing home ownership. Further, a rule which only allowed an exemption for the portion of a debtor's equity which resulted from mortgage payments would unfairly discriminate against debtors with satisfied mortgages. If the rule only allowed a debtor an exemption for equity acquired through making mortgage payments, a debtor with a satisfied mortgage would have to sell her home and acquire another (more expensive) home to realize an exemption on equity acquired during the 1215-day period.

Assume the market value of debtor Gamma's home is inflated as a result of a housing bubble. Housing bubbles are characterized by a "rapid expansion followed by a contraction."[82] Critics may argue that application of the proposed rule during a housing bubble would frustrate the fresh start and humanitarian policies behind the Code. For example, if Gamma elected to retain her home she would owe the bankruptcy estate $355,000.[83] Gamma could be unfairly harmed were she to liquidate other exempt assets, pay her debt to the bankruptcy estate, and retain her home. If the value of Gamma's home subsequently declined, the bankruptcy system would have encouraged a financially distressed individual to condense her holdings into a single asset. Prudent policy would encourage debtors to diversify their holdings, rather than suggest that debtors liquidate their assets and wager their entire financial well-being on the value of a single asset.[84]

It is unlikely that a debtor in Gamma's situation will have the financial resources to pay the amount owed to the bankruptcy estate on her principal residence.[85] Under the proposed rule, debtors in Gamma's situation would be incentivized to sell their homes rather than liquidate other exempt assets to retain their home. Instead of wagering their financial well-being on their principal residences, debtors will exit bankruptcy with liquid assets. A debtor who sells her home under the proposed rule will retain the amount of her homestead exemption. Thus, debtors will leave bankruptcy with up to $125,000 plus their equity interest on the 1216th day preceding the filing of the bankruptcy petition.

Consumer advocates will surely challenge the prudence of encouraging debtors to sell their homes. Dispossessing debtors of their homes is admittedly a costly process. Scholars often note that consumers have significant emotional ties to their home and community.[86] Home ownership

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82. INVESTOPEDIA FINANCIAL DICTIONARY, http://www.investopedia.com/terms/b/bubble.asp (last visited Dec. 20, 2006).

83. In the previous example Gamma owned a home valued at $500,000 and had a $145,000 homestead exemption.

84. *See* INVESTOPEDIA FINANCIAL DICTIONARY, http://www.investopedia.com/terms/d/diversification.asp ("Diversification is possibly the greatest way to reduce risk.") (last visited Dec. 20, 2006).

85. Gamma owed $355,000 to the bankruptcy estate as a result of the $500,000 market value of the home and the $145,000 exemption.

86. *See* Megan J. Ballard, *Legal Protection for Home Dwellers: Caulking the Cracks to Preserve Occupancy*, 56 SYRACUSE L. REV. 277, 307 (2006) (proposing a four-factor test to measure a subsidized home dweller's interest in remaining in their current home: "the length of the tenant's tenure in the dwelling at issue, the degree to which the

further promotes stability and development of social ties with one's neighbors.[87] Debtors will also bear significant transaction costs when they sell their home, search for a new home, and relocate their families.

At least part of the transaction cost burden can be shifted from the debtor to the bankruptcy estate as an administrative expense.[88] Administrative expenses are those expenses incurred by the debtor after filing for bankruptcy which become the responsibility of the estate rather than the debtor.[89] As an administrative expense, the bankruptcy estate will pay the shifted transaction costs.[90] Expenses arising from the sale of the debtor's house will likely qualify for administrative expense status because they arise from a transaction pursuant to the petition for bankruptcy and benefit the estate.[91] Other transaction expenses may also qualify as administrative expenses.[92] Classifying certain transaction costs as administrative expenses softens the hardships debtors face when they are asked to sell their homes and contribute to the bankruptcy estate any deficiency between the value of their home and their homestead exemption. By shifting the obligation of funding certain transactional expenses from the debtor to the estate, the Code fosters humanitarian treatment of the debtor.[93]

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tenant customized or improved his or her dwelling, the interests of children or other dependents who reside in the dwelling, and the reasonableness of the conduct or circumstances that put housing at risk"); *see also* O.W. Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 477 (1897) ("A thing which you have enjoyed and used as your own for a long time, whether property or an opinion, takes root in your being and cannot be torn away without your resenting the act and trying to defend yourself, however you came by it.").

87. *See* Eduardo M. Peñalver, *Property as Entrance*, 91 VA. L. REV. 1889, 1948-49 (2005) (discussing the role of property in fostering normative communities).

88. Administrative expenses are a type of expense that "have priority in the distribution of the assets of the estate." COLLIER ON BANKRUPTCY, *supra* note 7, at ¶ 503.01.

89. BLACK'S LAW DICTIONARY 45-46 (7th ed. 1999).

90. COLLIER ON BANKRUPTCY, *supra* note 7, at ¶ 503.01.

91. *See id.* at ¶ 503.06[3][a].

92. The list of administrative expenses in § 503(b) is nonexclusive:

> Section 503(b) states that the administrative expenses 'include' the nine listed categories. Section 102(3) provides that the terms 'include' and 'including' are not to be construed as limitations. The result is that the nine described categories cannot be considered an exhaustive list of all of the types of claims that are entitled to administrative priority treatment.

Id. at ¶ 503.05[1] (citations omitted).

93. This illustrates that the proposed rule does not intend to frustrate debtor rehabilitation. Instead, the proposed rule embodies an attempt to balance the competing policy tensions within bankruptcy law.

V. CONCLUSION

The *Blair* court's interpretation of the phrase "interest that was acquired" is contrary to both the common understanding of the term *equity* and the conclusion reached by a leading treatise in bankruptcy law.[94] Acquisition of interest refers to acquisition of equity rather than title. Any rule premised on a fundamental misunderstanding of the terms used in statutory language is inherently flawed.

This Note's proposed rule represents an accurate interpretation of § 522(p) and fosters fairness to creditors while ensuring that debtors retain sufficient liquid assets to begin life with a fresh start after discharge. The homestead exemption cap should apply to all equity acquired within the 1215 days preceding the filing of a bankruptcy petition. If courts do not interpret the § 522(p) cap in a manner consistent with this Note's proposal, Congress should intervene and amend the homestead exemption cap to clarify that the cap applies to all equity acquired within the 1215 days preceding the filing of a bankruptcy petition.

SHAUN MULREED

94. *See supra* Part III.