

CHAPTER 201: A “DEBTOR FRIENDLY” LAW¹

Statutes Affected: NEV. REV. STAT. 115.005

Statutes of Nevada: S.B. 70, 72d Sess. (Nev. 2003) (O’Connell); 2003 Nev. Stat. 201

I. Introduction

This comment focuses on the role of exemption laws in the bankruptcy process, with emphasis on the role of Nevada’s new homestead increase and its effect on consumer bankruptcy.

II. Exemption Laws and Bankruptcy

When a debtor is insolvent, creditors – including the government – have the power to collect the monies owed to them.² However, state exemption laws limit this power. State exemption laws are designed to block a creditor’s collection efforts against the debtor’s exempted property.³ Property shielded from creditors is considered exempt because it is “deemed necessary for an individual debtor’s economic functioning.”⁴

Exemption laws can be use outside or inside bankruptcy. Outside bankruptcy, exemption laws allow for property exemption from execution of judgments by creditors. Inside bankruptcy, these exemption laws work as a shield for debtors’ property from creditors.

Bankruptcy is a mechanism by which a debtor surrenders his “non exempt” assets – in a so called “estate” – in exchange for discharge of personal liability for all debts prior to commencement of the bankruptcy process.⁵ The goal in bankruptcy is to provide the debtor a “fresh start” from overwhelming debts while ensuring that creditors will get an equitable share of the debtor’s bankruptcy estate.⁶

Although the United States Constitution reserves the power to make bankruptcy laws to the federal government, this power does not include exemption laws. For 130 years, the federal government has allowed states to set their own property exemption laws.⁷ In 1978, Congress adopted federal bankruptcy exemptions but gave the states the right to “opt out” of these federal exemptions and adopt their own state exemptions.⁸

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² Lawrence Ponoroff & F. Stephen Knippenberg, *Debtors Who Convert Their Assets on the Eve of Bankruptcy: Villains or Victims of the Fresh Start?*, 70 N.Y.U. L. REV. 235 (1995).

³ CHARLES JORDAN TABB, *THE LAW OF BANKRUPTCY* § 9.1 (1997).

⁴ G. Marcus Cole, *The Federalist Cost of Bankruptcy Exemption Reform*, 74 AM. BANKR. L.J. 228, 228-29 (2000) (“Exemption statutes historically have been property based rather than dollar value based, largely in recognition of the uniqueness of “tools of trade,” the family bible and other items though necessary for a new beginning.”).

⁵ See Ponoroff & Knippenberg, *supra* note 2, at 237.

⁶ Wells M. Engledow, *Cleaning Up the Pigsty: Approaching a Consensus of Exemption Laws*, 74 AM. BANKR. L.J., 275, 276 (2000).

⁷ 145 CONG. REC. S14,481 (daily ed. Nov. 10, 1999) 1999 WL 1023124 (remarks of Sen. Kay Bailey Hutchison on Amend. No. 2778 to Amend. No. 2516, as modified, to Bankruptcy Reform Act of 1999, urging that states be allowed to opt-out of any homestead exemption cap).

⁸ See 11 U.S.C. § 522 (b)(1) (2002). See also William J. Woodward, *Exemptions, Opting Out, and Bankruptcy Reform*, 43 OHIO St. L.J. 335 (1982).

Two-thirds of the states opted out, Nevada being one of them.⁹ The “opt out” provision resulted in a great variety of property exemption laws around the United States. State exemptions differ sharply from state to state.¹⁰ The states with more generous property exemptions are known as “debtor friendly” states, while the states with less generous property exemptions are considered “creditor friendly” states. Because of the greater number and quantity of exemptions, debtors living in “debtor friendly” states are in a better position to shield their property against creditors when declaring bankruptcy.

III. Homestead Exemptions and the “Fresh Start” Goal

One of the most important exemptions in the process of bankruptcy is the homestead exemption.¹¹ It protects a debtor’s residence from the reach of creditors,¹² thus allowing the debtor to continue living in his “home” after bankruptcy. Due to the great variety of property exemption laws discussed above, homestead exemptions differ sharply across the nation.¹³ They range from “creditor friendly” states such as Delaware that do not allow for homestead exemptions, to “debtor friendly” states such as Florida or Texas that allow for unlimited exemptions.¹⁴ With the latest increase to a \$200,000 homestead exemption embodied in Chapter 201, Nevada has positioned itself as ninth in the rankings of “debtor friendly” states. Thus, Nevada may become an attractive target for “deadbeat” debtors seeking bankruptcy protection.¹⁵

Nevada shares its position with Minnesota, the only other state that allows a \$200,000 homestead exemption for rural residential property.¹⁶ Minnesota and Nevada are preceded by states with unlimited homestead exemptions: Arkansas, Florida, Iowa, Kansas, Oklahoma, South Dakota and Texas.

There are many policy reasons behind the goals of bankruptcy, specifically behind the enactment of debtor friendly homestead exemptions. Family integrity is one of the fundamental reasons: providing the debtor with a house for himself and his family is

⁹ Other states that have opted out of the federal exemptions are: Alabama, Alaska, Arizona, California, Colorado, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Mississippi, Missouri, Montana, Nebraska, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Utah, Virginia, West Virginia, and Wyoming. New Hampshire had opted out; however, the opt-out legislation was repealed effective January 1, 1997. 14 COLLIER ON BANKRUPTCY (15th ed. rev. intro. (2003)).

¹⁰ Richard E. Mendales, *Rethinking Exemptions in Bankruptcy*, 40 B.C. L. REV. 851, 856 (1999).

¹¹ Matthew J. Kemner, *Personal Bankruptcy Discharge and the Myth of the Unchecked Homestead Exemption*, 56 MO. L. REV. 683, 685 (1991).

¹² See Cole, *supra* note 4, at 228.

¹³ See discussion *supra* Part II.

¹⁴ See *supra* note 6, at 276.

¹⁵ See Margaret F. Brinig & F. H. Buckley, *The Market for Deadbeats*, 25 J. LEGAL STUD. 201, 202 (1996); see also Cole, *supra* note 4, at 229 (“‘Deadbeats’ are those ‘typically wealthy debtors who take advantage of exemption laws by venue selection.’”).

¹⁶ See MINN. STAT. § 510.02 (2002) (“The homestead may include any quantity of land not exceeding 160 acres, and not included in the laid out or platted portion of any city. If the homestead is within the laid out or platted portion of a city, its area must not exceed one-half of an acre. The value of the homestead exemption, whether the exemption is claimed jointly or individually, may not exceed \$200,000 or, if the homestead is used primarily for agricultural purposes, \$500,000, exclusive of the limitations set forth in section 510.05.”)

fundamental to debtor recovery.¹⁷ Providing the debtor his home will enable the debtor to protect his dignity and cultural and religious identity, to rehabilitate himself financially and earn income in the future, and to protect the debtor's family from the adverse consequences of impoverishment.¹⁸

IV. Chapter 201: Increasing the Homestead Exemption

Chapter 201 addresses property exemptions.¹⁹ It increases the amount of the homestead exemption in Nevada from \$125,000 to \$200,000.²⁰ It also increases the amount of other exemptions, such as the household goods exemption, from \$3,000 to \$10,000, and the one vehicle equity exemption from \$4,500 to \$15,000.²¹

Chapter 201 also creates new exemptions, such as: compensation for personal injuries not to exceed \$16,150, not including pain and suffering compensation or pecuniary loss; payments made to the debtor for the wrongful death of a person upon whom the debtor was dependent at the time of the wrongful death; payments received as restitution for criminal acts; payments received as disability, illness or unemployment benefits and payments for public assistance granted through welfare or a local government entity.²² This comment concentrates on the homestead provision, from its initial discussions through enactment.²³

Since the Legislature's prior increase of the homestead exemption in 1995, the homestead exemption has been set at \$125,000.²⁴ Senator O'Connell tried to increase the amount of homestead exemption during the 2001 Legislature but was unsuccessful.²⁵ In the 2003 session Senator O'Connell introduced a new bill to increase the homestead exemption ("Senate Bill 70").²⁶ Her efforts produced fruit this time. Senate Bill 70 was introduced on Feb. 7, the Senate and the Assembly approved it, and the Governor signed it on May 26, 2003.

Committee debates about Senate Bill 70 began with discussion regarding the mode of determining a new homestead value. Lobbying for the homestead increase were

¹⁷ See Kemner, *supra* note 11, at 686.

¹⁸ *Id.* at 684 n.7.

¹⁹ 2003 Nev. Stat. 201 §§ 1-2.

²⁰ Homestead is defined as the property consisting of:

- (a) A quantity of land, together with the dwelling house thereon and its appurtenances;
- (b) A mobile home whether or not the underlying land is owned by the claimant; or
- (c) A unit, whether real or personal property, existing pursuant to chapter 116 or 117 of NRS, with any appurtenant limited common elements and its interest in the common elements of the common-interest community, to be selected by the husband and wife, or either of them, or a single person claiming the homestead.

NEV. REV. STAT. 115.005 (2001).

²¹ *Id.* ("Equity means the amount resulting from subtracting the fair market value of the property minus the value of any liens excepted from the homestead exemption pursuant to subsection 3 of NRS 115.010.")

²² 2003 Nev. Stat. 201 §§ 4-5.

²³ *Id.* at §§ 1-2.

²⁴ See NEV. REV. STAT. 115.010 (2001).

²⁵ S.B. 83, 71st Sess. (Nev. 2001) (The bill was passed by the Senate during the 71st session but was rejected by the Assembly).

²⁶ S.B. 70 (As Introduced), 72d Sess. (Nev. 2003) § 1 (raising the homestead exemption to \$180,000.00).

the Southern Nevada Homebuilders Association and the Realtors Association.²⁷ Irene Porter, representing the Southern Nevada Homebuilders Association, provided statistics from Homebuilders Research Inc. According to their numbers, the median single-family home price in Las Vegas as of December 2002 was \$188,000.²⁸ This amount was predicted to increase to \$200,000 within the next two or three months. Ms. Porter indicated the market in Reno for housing to be \$15,000 to \$20,000 higher than the market in Southern Nevada,²⁹ thus, making the median price for housing in Reno \$210,000 as of December 2002. Ms. Porter reported the continued increase in home values over the past years from 6.5 to 8.5 percent per year, and the continued rise of resale rates from 10 to 12.5 percent per year.³⁰ Ms. Porter suggested \$200,000 as the amount of homestead exemption considering all the information presented above.³¹

During the debate, Senator Washington expressed concern about the impact of the construction defect litigation on the median price of homes.³² Ms. Porter answered Senator's Washington concerns, explaining that the cost of insurance due to construction defect litigation was already included in the rising costs of housing in Nevada.³³

Another inquiry made by Senator Washington surrounded the impact of setting the homestead exemption at \$180,000 instead of the suggested \$200,000.³⁴ Ms. Porter explained that the increase of the homestead exemption was not a matter of raising its value to conform to the raising value of housing. Instead, other costs should also have to be taken into consideration. These other costs included: the price of land, county and city fees, exactions, and taxes.³⁵ Thus, it would not be appropriate to change the homestead to only \$180,000.

Giving more support to the \$200,000 figure, Senator O'Connell presented newspaper articles from the *Las Vegas Review-Journal* that listed the median housing prices in January and April of 2003 as \$186,827 and \$187,535.³⁶ This data lent support for the projection that the median price for a home in Nevada would become \$200,000 in a short period of time.

After only three meetings and very little discussion, Senate Bill 70 was approved, increasing the homestead exemption to \$200,000, effective October 1, 2003.³⁷ This bill not only increased the property exemptions in Nevada to balance the increase in housing prices in Las Vegas, but also made Nevada a more "debtor friendly" state.

V. The Advantages of a Debtor Friendly State

²⁷ See *Minutes of S. Comm. on Judiciary for Feb. 13, 2003: Hearing on S. B. 70 Before S. Comm. on Judiciary*, 2003 Leg., 72d Sess. 9 (Nev. 2003).

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ See *Minutes of Assemb. Comm. on Judiciary for Apr. 29, 2003: Hearing on S.B. 70 Before Assemb. Comm. on Judiciary*, 2003 Leg., 72d Sess. 2 (Nev. 2003).

³⁷ See 2003 Nev. Stat. 201 §§ 1-2.

There are economic reasons for a state to become a “debtor friendly” state. According to Professors Brinig and Buckley, states may wish to attract debtors because these debtors – deadbeat debtors – in search for a debtor friendly state make desirable immigrants.³⁸ This type of debtor is, on average, a well-to-do professional with assets to protect.³⁹ “Many states find an influx of such assets advantageous, even if they happen to be accompanied by undesirable people.”⁴⁰

Professor Cole adds more to the previous reason, suggesting that a debtor friendly state will generate profits out of the new immigrant debtor. When the immigrant debtor moves from a creditor friendly state to a debtor friendly state, he may convert his non-exempt assets into exempt property in the state in which he will file bankruptcy.⁴¹ However, this debtor will eventually pay local taxes on this property thereby generating a profit for the state chosen by the debtor.⁴²

Professor Cole also considered the new “status” of the debtor after filing for bankruptcy. After filing bankruptcy in the debtor’s chosen state, the debtor will not be eligible for another bankruptcy for at least six years. Any new creditors will know, based on the debtor’s credit report of this new “bankruptcy status” and can take protective measures against the debtor, such as not extending credit. In other words, the sheltering “debtor friendly state” will become a safer credit risk after filing bankruptcy than before the filing.⁴³

Last, but not least, is the proposition put forth by economists Berkowitz and Hynes. They found that residents of debtor friendly states with high homestead exemptions experienced lower mortgage interest than creditor friendly states. The high homestead exemption states were more likely to convert non-exempt assets into home equity, thereby reducing the risk component of the interest charged on mortgages due to the preferential treatment to the mortgage lenders.⁴⁴

Of course, debtor migration to debtor friendly states also has its negative side effects. Some of the arguments against high state exemptions rest in the unfairness towards the unsecured creditor and the diminution in access to credit of the people living in high exemption states.

When debtors transfer their non-exempt assets into exempt property, creditors are left with the non-exempt assets to recover from the debtor.⁴⁵ The secured creditors may take their collateral out of the debtor’s estate,⁴⁶ however the unsecured creditor is left with only a pro-rata share of the debtor’s remaining non-exempt assets.⁴⁷ The big loser in this picture is the unsecured creditor.

Economists Gropp, Karl and White found that “residents of states with high or unlimited homestead exemptions get less credit, on average, than residents of states with

³⁸ See Brinig & Buckley, *supra* note 15.

³⁹ *Id.*

⁴⁰ Cole, *supra* note 4, at 253.

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.* at 254.

⁴⁵ See Kemner, *supra* note 11, at 685.

⁴⁶ *Id.*

⁴⁷ *Id.*

low homestead exemptions.”⁴⁸ These same people are more likely to be turned down for credit than people in low exemption states.⁴⁹

Taken together, all the reasons stated above show the benefits of high exemption states as compared to low exemption states. “Exemptions at any given level are ‘fair’ to the vast majority of debtors and creditors.”⁵⁰ The loss of the unsecured creditor is outweighed by the advantage of making a profit from the immigrant debtor. These unsecured creditors will end up taking steps to protect themselves from the high exemption state, thus covering the costs of their previous losses. For these reasons, it makes sense to compete for the “debtor friendly state” title, and Nevada is doing a good job.

VI Conclusion

While confronting a shaky economy due to the aftermath of the September 11 disaster and the war against terrorism, it may be possible that our better position as a debtor friendly state will encourage and promote a money influx into Nevada. Even for those not confronting the possibility of bankruptcy, the idea of living in a state that provides greater protections for their homes – one of their most precious assets – will enhance the virtues of Nevada as a good place to live and invest, thus encouraging investment and growth in Nevada.

⁴⁸ See Cole, *supra* note 4, at 234.

⁴⁹ *Id.*

⁵⁰ *Id.*