

## EXEMPTIONS FROM JUDICIAL PROCESS STUDY - BACKGROUND MEMORANDUM

Section 1 of House Bill No. 1213 (attached as [Appendix A](#)) directs a study of the current state exemptions for bankruptcy and the desirability of updating these exemptions. Section 2 of Senate Bill No. 2284 (attached as [Appendix B](#)) directs a study of the exemption provisions found in North Dakota Century Code (NDCC) Chapter 28-22, including determining whether the exemptions in the current form continue to serve the historical purposes of protecting debtors from creditors and providing debtors with the basic necessities of life, so that debtors will not be left destitute and public charges of the state. Because of the similarity in the studies directed by these two bills, the two studies have been combined into one comprehensive study.

### 2007 RELATED LEGISLATION

**House Bill No. 1213**, as introduced, would have amended NDCC Section 28-22-03.1(3) to treat pensions and annuity policies or plans differently from life insurance policies with respect to whether and the conditions under which each is exempt or not exempt from bankruptcy. Testimony regarding House Bill No. 1213 indicated that the wording of Section 28-22-03.1 raises questions as to whether an annuity is exempt from bankruptcy or whether it is only exempt after the death of the insured. It was noted that the exemptions provided for Chapter 28-22 are not just bankruptcy exemptions but are also exemptions from any judgment or process. Section 28-22-01 provides that the property mentioned in this chapter is exempt "from attachment or mesne process and from levy and sale upon execution and from any other final process issued from any court." The proposed changes to Section 28-22-03.1(3) were removed from the bill by amendment and the proposed study was added.

**Senate Bill No. 2221** addressed the effect of bankruptcy on a judgment lien. The bill provided that if a judgment lien appears on a judgment debtor's real property and the debtor is later the subject of bankruptcy proceedings in which the judgment lien is avoided or set aside, the judgment lien may be terminated of record by filing a certified copy of the bankruptcy court lien avoidance judgment. The bill also repealed NDCC Sections 28-20-30, 28-20-31, and 28-20-32, which related to the cancellation of judgment against bankrupts, service in bankruptcy proceedings, and affidavits in bankruptcy proceedings.

**Senate Bill No. 2284**, as introduced, would have amended NDCC Section 28-22-03.1(4) to remove the caps on the amount that a debtor may exempt which is traceable a wrongful death or personal bodily injury award. As passed, Senate Bill No. 2284 increased the amount that is exempt from this source from

\$7,500 to \$15,000. Section 2 of this bill, which was included in an amendment added in the Senate, provided for this study of exemptions.

### BACKGROUND

A debtor who wants to keep property from creditors has the right to claim certain items of property exempt from process. The Constitution of North Dakota as well as various North Dakota statutes provide for a debtor's right to exemptions. Article XI, Section 22, of the Constitution of North Dakota addresses the right to exemptions as well and provides:

The right of the debtor to enjoy the comforts and necessities of life shall be recognized by wholesome laws, exempting from forced sale to all heads of families a homestead, the value of which shall be limited and defined by law; and a reasonable amount of personal property; the kind and value shall be fixed by law. This section shall not be construed to prevent liens against the homestead for labor done and materials furnished in the improvement thereof, in such manner as may be prescribed by law.

In addition to the statutory and constitutional provisions, federal and state courts have held that there are public policy reasons for providing exemptions. According to the California Court of Appeals in *Bertozzi v. Swisher*, 82 P.2d 1016 (Cal. Ct. App. 1938), "the fundamental reason for the enactment of exemption laws is to protect a person, whatever his occupation might be, from being reduced by financial misfortune to abject poverty; therefore, to accomplish that end and to encourage industry and thrift, laws of that type have been framed which place beyond the reach of creditors not only the debtor's home but also various kinds of personal property reasonably necessary for him to have in order to earn a living for himself and his family . . . ." In a 1988 decision, the Eighth Circuit Court of Appeals in *Norwest Bank Nebraska v. Tveten*, 848 F.2d 871 (8<sup>th</sup> Cir. 1988), held that the public policy reason for the homestead exemption, and for allowing the debtor to pay down on the homestead mortgage before filing bankruptcy, is to "protect the family unit from impoverishment, relieve society of the burden of supplying subsidized housing, and provide the debtors with a means to survive during the period following the bankruptcy filing when the debtor may have little or no income." The North Dakota Supreme Court, in *Seablom v. Seablom*, 348 N.W.2d 920 (N.D. 1984), stated "[e]xemptions statutes are remedial and are to be liberally construed to effectuate their purpose of their enactment. Exemption statutes have two major objectives: To provide a fresh start to the debtor who is being sued and to aid society by reducing the

number of debtors who would need public assistance."

### Federal Bankruptcy Laws

Article 1, Section 8, of the Constitution of the United States authorizes Congress to enact "uniform Laws on the subject of Bankruptcies throughout the United States." Congress has exercised this authority several times since 1801, most recently by adopting the Bankruptcy Reform Act of 1978, codified in Title 11 of the United States Code, commonly referred to as the Bankruptcy Code. The Bankruptcy Code has been amended several times since 1978, most recently in extensive amendments in 2005 through the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. Other laws relevant to bankruptcy are found in other parts of the United States Code. For example, bankruptcy crimes are found in Title 18 of the United States Code; tax implications of bankruptcy are found in Title 26 of the United States Code in the Internal Revenue Code; and the creation and jurisdiction of bankruptcy courts are found in Title 28 of the United States Code, which provides for judiciary and judicial procedure.

While bankruptcy cases are always filed in United States bankruptcy court, which are units of the United States district courts, and federal law procedurally governs bankruptcy cases, state laws are often applied when determining property rights. For example, law governing the validity of liens or rules protecting certain property from creditors, known as exemptions, are derived from state law.

### North Dakota Law Regarding Exemptions

As previously mentioned, the federal Bankruptcy Code has established its own scheme of exemptions. Section 522 of the federal Bankruptcy Code, which provides for the property that is exempt, permits a state to opt out of the federal exemptions. North Dakota opted out of the federal bankruptcy exemption scheme in 1981. North Dakota Century Code Section 28-22-17 provides that "[i]n accordance with the provisions of section 522(b) of the Bankruptcy Reform Act of 1978 [Pub. L. 95-598; 92 Stat. 2586; 11 U.S.C. 522(b)], residents of this state are not entitled to the federal exemptions provided in section 522(d) of the Bankruptcy Reform Act of 1978. The residents of this state are limited to claiming those exemptions allowable by North Dakota law." Consequently, a North Dakota resident is restricted to those exemptions created in North Dakota law.

### Chapter 28-22 - Exemptions

As previously mentioned, NDCC Chapter 28-22 sets forth the property that is exempt from process in North Dakota. The "process" to which this chapter refers includes attachment, levy and sale upon execution, bankruptcy, and any other final process issued from any court. Chapter 28-22 includes exemptions that can be divided into two categories.

The first set of exemptions specifically describes items of property and classes of exempt property. For

example, NDCC Section 28-22-02 exempts as "absolute exemptions" family pictures, a family pew, the family Bible, schoolbooks, the family library, wearing apparel and clothing, food and fuel, the homestead as defined and limited by law, a certain amount of crops and grain, insurance benefits resulting from insurance covering the absolute exemptions, and any house trailer or mobile home occupied as a residence by the debtor. In addition, Section 28-22-03.1 provides for a motor vehicle exemption, not to exceed \$1,200; annuities; retirement plans; life insurance; and payments traceable to wrongful death and personal injury awards; a Social Security benefit; and veteran's disability pension benefits. Section 28-22-04 provides exemptions for miscellaneous books and musical instruments, not exceeding \$1,000 in value; household and kitchen furniture, not exceeding \$1,000 in value; livestock and farm implements, not exceeding \$4,500 in value; the tools and implements of any mechanic, not exceeding \$1,000 in value; and the library and instruments of any professional person, not exceeding \$1,000 in value. Section 28-22-19 exempts "from liability for debts of the person to or on account of whom the amounts are paid, and are not subject to seizure upon execution or other process:

1. All pensions or annuities or retirement, disability, death, or other benefits paid or payable by, or amounts received as a return of contributions and interest from, a retirement system established pursuant to state law by the state except as provided by sections 15-39.1-12.2, 39-03.1-14.2, 54-52-17.6, and 54-52.2-03.3, a state agency, a political subdivision of the state, or a firefighters relief association for retirement, annuity, pension, disability benefit, or death benefit purposes. The exemption in this subsection does not apply to the collection of child support unless federal law requires an exemption or if complying with an execution or other process would require an actuarial analysis to determine the current value of the amounts that are payable to the debtor.
2. All awards made pursuant to chapter 54-23.4 as compensation for victims of crimes.
3. All payments of assistance as aid to dependent children pursuant to chapter 50-09."

The other set of exemptions applies to any property the debtor seeks to exempt. These exemptions set a dollar value limit on property that the debtor is permitted to shelter. These include NDCC Section 28-22-03, which allows a debtor, as head of a family, to take a \$5,000 exemption in any property. Section 28-22-02 allows a single person to take a \$2,500 exemption in any property. Section 28-22-03.1(1) permits an additional \$7,500 in any other property if the debtor does not use the

homestead exemption. Section 28-22-16 provides that in addition to the absolute exemptions against process, the debtor may take a \$500 exemption on property of any kind.

#### **Section 47-18-01 - Homestead Exemption**

North Dakota Century Code Section 47-18-01 provides for the homestead exemption. This section provides that the homestead of any person residing in this state consists of the land upon which the person resides and "the dwelling house on that land in which the homestead claimant resides, with all its appurtenances, and all other improvements on the land, the total not to exceed eighty thousand dollars in value, over and above liens or encumbrances or both." This section also provides that the homestead is exempt from judgment lien and from execution or forced sale, except as otherwise provided in this chapter. According to this section, the homestead may not include different lots or tracts of land unless they are contiguous.

#### **Section 28-25-11 - Earnings Exemption**

North Dakota Century Code Section 28-25-11 provides that the earnings of the debtor earned in the 60 days preceding the order cannot be used to satisfy the judgment if the debtor can show, by affidavit or otherwise, that "the earnings are necessary for the use of a family supported wholly or partly by the debtor's labor."

#### **Section 32-09.1-03 - Restriction on Garnishment of Earnings**

North Dakota Century Code Section 32-09.1-03(1) limits the amount of earnings that may be garnished to satisfy a judgment. Section 32-09.1-03(3), however, provides that the restrictions of subsection 1 do not apply in the case of an order of any court of bankruptcy under Chapter XIII of the Bankruptcy Act.

#### **Section 26.1-33-36 - Rights in Life Insurance Policies Exemption**

North Dakota Century Code Section 26.1-33-36 provides that "[t]he surrender value of any life insurance policy which, upon the death of the insured, would be payable to the spouse, children, or any relative of the insured dependent, or likely to be dependent, upon the insured for support, is exempt absolutely from the claims of creditors of the insured to the extent provided in section 28-22-03.1." This section also provides that neither a creditor nor a court may require an insured to surrender a life insurance policy, except for the value of the policy which is in excess of the amount provided by Section 28-22-03.1. This section provides that the excess amount may be subject to seizure under any process of any court under any circumstance.

#### **Section 26.1-33-40 - Avails of Life Insurance Policy Exemption**

North Dakota Century Code Section 26.1-33-40 provides that the "avails of a life insurance policy or of

a contract payable by any mutual aid or benevolent society, when made payable to the deceased, to the personal representatives of the deceased, to the deceased's heirs, or to the deceased's estate, is not subject to the debts of the decedent upon the death of the insured or member of the society except by special contract."

#### **Section 52-06-30 - Assignment of Unemployment Benefits**

North Dakota Century Code Section 52-06-30 prohibits the assignment, pledge, or encumbrance of any right to benefits payable under the North Dakota Unemployment Compensation Law. This section provides that the rights to benefits are exempt from levy, execution, attachment, or any other remedy provided for the collection of a debt. This section also provides that unemployment benefits "received by any individual, as long as they are not mingled with other funds of the recipient, are exempt from any remedy for the collection of all debts except debts incurred for necessities furnished to the individual, that person's spouse, or dependents during the time when the individual was unemployed."

#### **Section 65-05-29 - Assignment of Workers' Compensation Claims**

North Dakota Century Code Section 65-05-29 provides that "[a]ny assignment of a claim for compensation under this title is void." The exceptions to this provision are a child support obligation ordered by a court of competent jurisdiction; a claim by Job Service North Dakota for reimbursement of certain unemployment benefits; or a claim by Workforce Safety and Insurance for a payment made due to a clerical error, an adjudication by Workforce Safety and Insurance or a court, fraud, or an overpayment.

### **SUGGESTED STUDY APPROACH**

The committee, in its review of statutory exemptions, may wish to approach this study as follows:

- Receive information regarding the state's exemptions from process and how those exemptions serve the purposes of protecting a debtor and how those exemptions compare to the federal exemptions and the exemptions of other states;
- Receive information and testimony from bankruptcy trustees, attorneys, creditors, and others interested in a review of statutory exemptions; and
- Develop recommendations and prepare legislation necessary to implement the recommendations.

ATTACH:2