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United States Senate  
Washington, D.C. 20510

Congressman F. James Sensenbrenner  
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Dear Senator Leahy and Congressman Sensenbrenner:

At its April 23, 2002, meeting, the conference committee on the pending bankruptcy legislation reached a tentative compromise on the treatment of the unlimited homestead exemption that undermines the integrity of the entire federal bankruptcy system. The compromise proposal does not cure the homestead problem. Although the homestead compromise was reached in good faith and with good intentions, its modest improvements are overwhelmed by the negative consequences it will have. On balance, the compromise compounds the unfairness of the homestead exemption.

Under the pending version of the bill, not only will the wealthy and the well-counseled continue to find complete shelter from their creditors in a few states, but also they will continue to be able to transport their unlimited exemptions if they move to a state with a limited exemption. Should it become law, the proposed language might prevent a few Enron executives from abusing the unlimited homestead exemption in Texas, although even that conclusion is far from certain. Yet it almost certainly will lead to new headlines and new scandal when the wealthy begin to appreciate the new opportunities it presents, inadvertently to be sure, to take advantage of their creditors.

We write, as a diverse group of professors who teach bankruptcy and commercial law, to urge you to revisit this vital issue. We appreciate very much your previous efforts to address the problem. Whatever the ultimate result, we ask that you critically review the proposed language in light of the bill's other provisions and the varying state laws with which it will be construed by the courts at the request of debtors seeking immunity from the legitimate claims against them.

Today, bankruptcy law yields to state law to determine what property shall remain exempt from creditor attachment and levy. 11 U.S.C. § 522(b)(2). Homestead exemptions are highly variable by state: six states (Arkansas, Florida, Iowa, Kansas, South Dakota, Texas) and the District of Columbia now have literally unlimited exemptions while twenty-two states have exemptions of \$15,000 or less.

The central purpose of the Senate's uniform federal cap on the homestead exemption was to ameliorate the fundamental unfairness created when residents of one state can protect in a "uniform" federal bankruptcy system an asset worth millions while residents of other states face sharp limitations on the amount of property they can protect. Under current law, a wealthy investor in Texas can keep an unencumbered home worth \$10 million while a factory worker in Virginia puts at risk anything over \$10,000 in equity. The wealthy investor and factory worker

both obtain credit in the same national market for credit and file for bankruptcy under the same federal bankruptcy law, but their bankruptcy cases have drastically different outcomes. The compromise proposal would cap the homestead *only* for persons accused of certain bad acts, and even then, the cap would be \$125,000. Under the proposal, a felon or a person who committed fraud in a fiduciary capacity could exempt \$125,000 in a Texas, Florida, or Kansas homestead, but the Virginia factory worker still is limited to \$10,000.

Instead of offering a hard, uniform cap that brings the state exemptions into closer alignment, the proposal makes it more difficult for people to use any homestead exemptions. Even within this limited scope, however, the proposal fails to solve the fundamental problem of unfairness while it creates new problems.

***Loopholes.*** The proposal provides that when a debtor moves, the debtor's home-state exemptions shall apply for two years after the move. This means that a Texan who moves, for example, to New York brings an unlimited exemption for two years, trading the protection of a Texas ranch for the protection of a Park Avenue apartment. This accentuates the disparate treatment. By the statute's operation, for two years after moving the Texan would enjoy a \$125,000 exemption, considerably better treatment than that available to his New York neighbor. (If the debtor had owned a Manhattan apartment prior to moving from Texas, under some circumstances the exemption would be unlimited.) Under the proposal, a long-time New Yorker would be able to protect \$10,000 in home equity, while a newly arrived Texan who moved next door could protect \$125,000.

A wealthy person in a limited-exemption state who had good legal advice and some advance planning could make the provisions work in his favor as well. Depending on the quirks of local law, someone who owned a multimillion dollar home in Connecticut, for example, could move to Arkansas for a few months, establishing Arkansas as his domicile without selling his Connecticut property, then move back to Connecticut, wait nearly two years and file for bankruptcy. The proposal would require the Connecticut court to apply the unlimited Arkansas homestead, permitting the wealthy Connecticut homeowner to shield millions. A portable homestead exemption can become the next planning tool for the wealthy of every state.

***Traps.*** Exporting exemptions could have the reverse effect as well. Oklahoma exemptions, for example, are written to protect only property in Oklahoma. This means that an Oklahoma homeowner who sold her \$40,000 house, moved to Texas and bought a \$40,000 Texas home, would have *no* homestead exemption for two years. If she files for bankruptcy within two years of her move, she risks losing even the most modest house.

***Too Many Loopholes for Fraud.*** The new provisions to limit homestead protection for a few people--those who violate securities laws, who commit fraud while in a fiduciary capacity, or who commit certain felonies or intentional torts--are too tightly drawn. They will create a playground of loopholes for wealthy individuals and clever lawyers. Moreover, while Enron executives may be uppermost in minds today, others have fled to the bankruptcy courts after injuring innocent victims, and more will do so again in the

future. These provisions do not cap the homestead exemption for someone who finds a dozen ways to bilk the elderly out of their money, someone who takes advantage of first-time home buyers, or someone who deceives people trying to set up college funds for their children.

***Litigation Instead of Reform.*** In the day-to-day world of the bankruptcy courtroom, the compromise proposal is unnecessarily impractical. To respond to the perceived evils of the Enron debacle, the proposal links limitations on exemptions to findings of bad acts under other laws. But there is no guaranty that these findings under other laws will be made before bankruptcy, thus multiplying litigation effects as lawyers scramble to avoid the preclusive effect of one proceeding upon another. Also, the proposal creates new problems in negotiating settlements for the wrongs it specifies, as victims will push for an admission of wrongdoing in the settlement that the debtor will just as forcefully resist. The trap set for “bad” debtors who look like Enron executives will snare thousands of hapless others in its net. All this is taken on solely so that other millionaires will be permitted to keep their mansions in a handful of states.

While we are not all in agreement about what a homestead cap should be – whether it should be the \$125,000 as agreed to by the Senate or something else – we all do agree that the agreement in the Conference Committee will not do anything to close the “luxury loophole” that wealthy debtors now enjoy. The problems we identify can be solved with a hard cap on the homestead exemption. In a bill designed to squeeze hard on working families who have faced unemployment, medical bills and divorce, it is profoundly unfair to leave open a gaping loophole for the richest executives, doctors, and media stars. The headlines that will surely follow the next scandal will discredit the notion that the homestead problem has been fixed.

Very truly yours,

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