

Date of Hearing: June 28, 2022

ASSEMBLY COMMITTEE ON JUDICIARY
Mark Stone, Chair
SB 1099 (Wieckowski) – As Amended June 23, 2022

SENATE VOTE: 28-7

SUBJECT: BANKRUPTCY: DEBTORS

KEY ISSUE: SHOULD CALIFORNIA DEBTORS WHO SEEK FEDERAL BANKRUPTCY PROTECTION BE ABLE TO PROTECT MORE OF THEIR ASSETS FROM FORCED SALE TO SATISFY CREDITORS?

SYNOPSIS

Californians who are unable to pay their debts can file for federal bankruptcy protection. Bankruptcy is available both to individuals and to businesses, including corporations. Pervasive stereotypes depict bankruptcy filers as financially illiterate, or as deadbeats who spent beyond their means for luxuries. In fact, most people who file for bankruptcy are members of the middle class, who were managing their finances adequately until they suffered an unexpected income shock. The most common reasons for declaring bankruptcy are unforeseeable: medical expenses, losing a job, or losing a spouse, whether through divorce or death.

California law establishes a series of exemptions to protect a baseline amount of debtors' assets from seizure by creditors. The purpose of these exemptions is to ensure that the debtor and the debtor's family are able to meet basic needs, and not be deprived of their ability to make a living—even if they declare bankruptcy. Exemptions are meant to give the debtor a fair chance to rebuild; otherwise, bankruptcy would likely drive debtors further into debt to afford necessities of life such as food, housing, and transportation.

This bill would make several important changes to California exemptions, including:

- 1. Ensuring that any appreciation in home equity during a bankruptcy proceeding remains the debtor's, mirroring a similar change in Washington law in response to a Ninth Circuit Court of Appeals decision.*
- 2. Establishing that bankruptcy does not trigger an automatic default in an auto loan, protecting the debtor's car from being repossessed simply due to a bankruptcy filing.*
- 3. Permitting a bankruptcy filer who is separated from and not communicating with their spouse, e.g., due to a domestic violence restraining order, to make an election of bankruptcy exemptions without their spouse's consent.*

This bill is sponsored by the National Association of Consumer Bankruptcy Attorneys, and supported by Consumer Federation of California. It is opposed by trade associations representing lenders and creditors, several businesses that specialize in collecting on judgments, and a group of bankruptcy trustees.

SUMMARY: Makes several changes to the statutory exemptions that govern the minimum of property California debtors may retain if they file for bankruptcy. Specifically, **this bill:**

- 1) Provides that in a bankruptcy case where the debtor's equity in a residence is less than or equal to the amount of the debtor's allowed homestead exemption as of the date the bankruptcy petition is filed, any appreciation in the value of the debtor's interest in the property during the pendency of the action is exempt.
- 2) Specifies that neither filing for bankruptcy protection nor one's status as a debtor in bankruptcy constitutes a default under a conditional sales contract for a motor vehicle or under a loan secured by a lien on a motor vehicle. Further specifies that neither such a filing nor status may be used as a basis for accelerating any of the amount due under the contract or loan, or for repossessing the motor vehicle.
- 3) Provides, in furtherance of 2), that a provision of a conditional sales contract is void and unenforceable if it states that filing for bankruptcy protection or that one's status as a debtor in bankruptcy is a default.
- 4) Enacts the following changes to the statutory "703 exemptions," an alternative to the default "704 exemptions" that specify what property and assets debtors can keep in bankruptcy:
 - a) Clarifies that professionally prescribed health aids for the debtor's spouse are exempt.
 - b) Deems exempt any payments under settlement agreements arising out of a debtor's employment, to the extent reasonably necessary for the support of the debtor, the debtor's spouse, or a dependent.
 - c) Deems exempt payments for wrongful death, under a life insurance contract, due to personal bodily injury, or for loss of the decedent's future earnings if the decedent was the debtor's spouse.
- 5) Enacts the following changes to both the 703 and 704 exemptions:
 - a) Increases the amount of equity in a motor vehicle that is exempt to \$9,500 from the current \$3,625 under the 703 exemptions or \$6,375 under the 704 exemptions.
 - b) Treats as an exempt health aid a motor vehicle that has been altered to accommodate disabilities, such as by installing a wheelchair lift.
 - c) Deems exempt up to \$7,500 in accrued, or unused, vacation pay, sick leave, family leave, and in vacation credits. (The 703 exemptions are amended to also include wages.)
 - d) Deems exempt alimony, support, and separate maintenance, to the extent reasonably necessary for the support of a debtor and any dependent.
- 6) Permits a married person who files individually for bankruptcy and elects to utilize the 703 exemptions to not have to obtain a written waiver of the 704 exemptions from their spouse, if the couple is separated and living apart on the date the bankruptcy petition is filed. Nevertheless, both spouses must sign if both spouses share an interest in a homestead.

EXISTING LAW:

- 1) Defines "judgment creditor" as a person in whose favor a judgment is rendered. (Code of Civil Procedure Section 680.240. Unless otherwise noted, all further references are to this code.)

- 2) Defines “judgment debtor” as a person against whom a judgment is rendered. (Section 680.250.)
- 3) Defines “money judgment” as that part of a judgment, entered in a California court, which requires the payment of money. (Sections 680.230, 680.270.)
- 4) Specifies, except where the law provides otherwise, that all property of a judgment debtor is subject to enforcement of a money judgment. (Section 695.010.)
- 5) Establishes a set of exemptions, known as the “704 exemptions” from enforcement of a money judgment, including a homestead exemption, and exemptions for designated values of, e.g., household furniture and appliances, the equity in a motor vehicle, clothing, tools of trade, the amounts in a bank account and in retirement accounts, and so forth. (Sections 704.010 – 704.995.)
- 6) Establishes a set of exemptions, known as the “703 exemptions,” for assets during a bankruptcy proceeding, including interests in: real property, household furniture and appliances, motor vehicles, clothing, tools of trade, certain retirement accounts, and so forth. (Section 703.140.)
- 7) Disallows a natural person filing for bankruptcy in California from availing themselves of exemptions available under federal bankruptcy law. (Section 703.130.)
- 8) Allows a natural person filing for bankruptcy to choose between the 704 exemptions for judgment debtors referenced in 5) and the bankruptcy 703 exemptions referenced in 6). (Section 703.140 (a).)
- 9) Requires, if a married person files individually (rather than the couple filing jointly) for bankruptcy and wants to use the 703 exemptions, that both spouses have to waive the 704 exemptions in writing. (Section 703.140 (a)(2).)
- 10) Requires the Judicial Council, every three years, to adjust the dollar amounts of designated exemptions to account for inflation. (Section 703.150.)
- 11) Requires the Legislature, pursuant to the California Constitution, to protect a certain portion of the homestead and other property, from forced sale. (California Constitution, article XX, section 1.5.)
- 12) Defines a “dwelling” as a place where a person resides. (Section 704.710 (a).)
- 13) Defines a “homestead” as the principal dwelling in which the judgment debtor or the debtor’s spouse resided in continuously from the date on which the judgment lien attached to the dwelling until the date on which the court determined the dwelling was a homestead. (Section 704.710 (c).)
- 14) Provides judgment debtors with a homestead exemption: the right to retain a certain amount of the proceeds when the court orders that a homestead be sold in order to satisfy a money judgment. (Section 704.720.)
- 15) Establishes the 704 homestead exemption as the greater of \$300,000 or the countywide median sale price of a single-family home in the calendar year prior to the year in which the

judgement debtor claims the exemption, not to exceed \$600,000, with all figures to be adjusted for inflation annually. (Section 704.730.)

- 16) Exempts the debtor's interest in one or more motor vehicle of \$6,375 under the 703 exemptions or \$3,625 under 704 exemptions. (Section 703.140 (b); Section 704.010; all as adjusted for inflation by the Judicial Council.)
- 17) Establishes the Automobile Sales Finance Act, also known as the Rees-Levering Motor Vehicle Sales Finance Act, to regulate the sales of automobiles pursuant to conditional sales contracts. (Civil Code Sections 2981-2984.6.)
- 18) Defines "conditional sale contract" as a contract to purchase a motor vehicle primarily for personal, family, or household purposes, with or without accessories, under which the buyer takes possession of the vehicle, but either a) obtains title only upon payment of the purchase price, or b) provides the seller a lien on the vehicle as security for payment of the purchase price. (Civil Code Section 2981 (a)(1).)
- 19) Allows, after default by a motor vehicle buyer on a conditional sales contract or on a loan secured by a motor vehicle, the seller, holder, or lender (as applicable) to repossess or voluntarily accept surrender of the motor vehicle. (Civil Code Sections 2983.2, 2983.3.)
- 20) Prohibits, in the absence of a default by the buyer, the seller or other holder of a conditional sales contract or a loan secured by a motor vehicle buyer from either (a) accelerating the maturity of any part or all of the amount due or (b) repossessing the motor vehicle. (Civil Code Section 2983.3 (b); Financial Code Section 22329 (b).)

FISCAL EFFECT: As currently in print this bill is keyed non-fiscal.

COMMENTS: A debtor who is unable to pay their debts may seek relief from creditors by filing for bankruptcy, a protection that federal law has offered since 1800. Bankruptcy is available both to individuals and to businesses, including corporations.

Pervasive stereotypes paint bankruptcy filers as financially-illiterate, or as deadbeats who spent beyond their means for luxuries. In fact, most people who file for bankruptcy are members of the middle class, who were managing their finances adequately until they suffered an unexpected income shock. The most common reasons for declaring bankruptcy are unforeseeable: medical expenses, losing a job, or losing a spouse, whether through divorce or death. (*See, e.g., Sullivan, et al., Less Stigma or More Financial Distress: An Empirical Analysis of the Extraordinary Increase in Bankruptcy Filing* (2006) 59 Stanford Law Review 213, 220 ["Among the debtors filing for bankruptcy in 2001, 91.8% had been to college, had an occupation in the upper 80% of all occupations (as ranked by prestige), or had bought a home."].)

California law establishes a series of exemptions to protect a baseline amount of debtors' assets from seizure by creditors. The purpose of these exemptions is to ensure that the debtor and the debtor's family are able to meet basic needs, and not be deprived of their ability to make a living—even if they declare bankruptcy. Exemptions are meant to give the debtor a fair chance to rebuild; otherwise, bankruptcy would likely drive debtors further into debt to afford unavoidable necessities of life such as food, housing, and transportation.

This bill would increase certain exemptions and make other exemptions operate more effectively. According to the author:

While crucial updates have been made to our bankruptcy code in recent years, SB 1099 captures some remaining key improvements still needed so that bankruptcy is truly available to those who need it and that we leave a consumer with enough to rebuild after the bankruptcy.

As noted by the Senate Judiciary Committee in its analysis, this bill “could be fairly characterized as a bankruptcy exemptions omnibus.” The bill’s modifications to how bankruptcy exemptions operate in California are discussed below.

Background re: bankruptcy & exemptions. A natural person typically files for bankruptcy under Chapter 7 or Chapter 13 of the United States Bankruptcy Code, thereby seeking to either discharge most of their debts completely (under Chapter 7, which is means-tested) or to repay part of their debts through a court-structured repayment plan (under Chapter 13). The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) revised the United States Bankruptcy Code as it applies to bankruptcy cases filed on or after October 17, 2005. BAPCPA made it more difficult for debtors, especially those with high incomes, to discharge all of their debts in Chapter 7. BAPCPA also increased to eight years, the waiting period from when an individual last filed Chapter 7 bankruptcy to when they may file again. (*Ibid.*)

Code of Civil Procedure Sections 704.010 *et seq.* establish the main set of exemptions available to judgment debtors in California facing a judgment creditor’s collection attempts. These exemptions are often referred to as “704 exemptions.” A person who declares bankruptcy in California may avail themselves of either the 704 exemptions or a separate, but similar, set of exemptions set forth at Code of Civil Procedure Section 703.140 (b), commonly known as “703 exemptions.” The Judicial Council adjusts the amount of the exemptions for inflation every three years; the latest amounts, effective April 1, 2022, can be found on Form EJ-156. (*See* <https://www.courts.ca.gov/documents/ej156.pdf>.) Essentially, a debtor can decide which set of exemptions is preferable based on their own situation. The crucial difference is that the 704 exemptions provide greater protections for home equity under the homestead exemption, a subject of this bill.

Provisions affecting the home. The California Constitution requires the Legislature to protect a “homestead”—essentially, the equity in a debtor’s principal residence, if the debtor owns their home—of a certain value from being seized for the benefit of creditors. (California Constitution, article XX, section 1.5.) Most recently, in AB 1885 (Budget, Chap. 94, Stats. 2020), the Legislature set the homestead exemption to the greater of (i) \$300,000 or (ii) the median sale price of a single-family home in the county where the home is located, for the calendar year prior to the year in which the debtor claims the exemption, not to exceed \$600,000. (Code of Civil Procedure 704.730.) Both of these amounts are adjusted annually for inflation.

A potential problem arises, however, if the value of the debtor’s home is below the homestead exemption when the debtor files for bankruptcy protection but then grows above the exemption if the case goes on too long. As explained by the National Association of Consumer Bankruptcy Attorneys:

[I]n a bankruptcy case, a trustee can sell a debtor's home well after the bankruptcy case is filed, and all the accrued increase in equity is paid to the trustee, not the debtor-homeowner. This is the result of a 9th Circuit Court of Appeals case, *In re Gebhart* (9th Cir. 2010) 621 F.3d 1206. In the *Gebhart* case, the chapter 7 bankruptcy trustee waited more than three years after the case was filed before seeking to sell the house and claiming the accrued equity appreciation that exceeded the debtor's homestead amount. As a result, the debtor lost the benefit of his having increased the equity in his home by paying down the mortgage for the three years until the trustee moved to sell the house. Although *Gebhart* involved an Arizona debtor, the *Gebhart* holding applies to homeowners in California as well....

In *Gebhart*, the Ninth Circuit further explained that "all statutes that limit the value of an exemption to an 'interest' in property capped at a dollar value" could run afoul of this problem, i.e., that the debtor could end up losing the asset due to the passage of time. (621 F.3d at 1211.) Accordingly, this bill provides, in pertinent part: "In a case where the debtor's equity in a residence is less than or equal to the amount of the debtor's allowed homestead exemption as of the date the bankruptcy petition is filed, any appreciation in the value of the debtor's interest in the property during the pendency of the action is exempt." Washington, which is also in the Ninth Circuit and therefore subject to *Gebhart*, recently enacted a similar provision in its code: "Any appreciation in the value of the debtor's exempt interest in the property during the bankruptcy case is also exempt, even if in excess of the amounts in [the homestead exemption amount]." (Wash. Rev. Code 6.13.070.)

The group Trustees for Reasonable Homestead Exemption Limits opposes the bill unless it is amended to remove this provision. Among their arguments is that the provision is unnecessary because the federal bankruptcy code already provides debtors with tools to have exempt property removed from administration by the bankruptcy trustee. They write:

When a debtor files a bankruptcy case, for the most part all of the property that the debtor owns becomes property of the "bankruptcy estate" that is controlled by their appointed chapter 7 trustee. The added § 703.140 (c) is intended to address a concern that a bankruptcy trustee may not expeditiously administer a case because there is an incentive to wait for property to appreciate in value. However, the Bankruptcy Code already provides a solution. In such a situation, the debtors can immediately move for abandonment under § 554 (b) of the Bankruptcy Code. It is a simple motion. Thus, the Bankruptcy Code has already addressed this alleged issue of trustees waiting for assets to appreciate. The unnecessary addition will effectively absolve the debtors and their counsel from their duties to follow the Bankruptcy Code.

Committee staff has spoken to bankruptcy practitioners and confirmed that the motion for abandonment referenced here is not as straightforward as the opponents characterize. For one, when the motion is made, it can be highly contested, meaning that the result is not predictable. If the debtor loses, the increase in the value of the homestead will remain in the bankruptcy estate, and likely forfeited to creditors, simply because of delays in the case—unlike the exemption in statute, which is automatic and persists no matter how long the case takes. Further, motions are costly. A debtor may have to pay their attorney several thousand dollars to prepare and argue a contested motion. But, by definition, a debtor declaring bankruptcy, particularly under Chapter 7, is someone who lacks the resources to pay their debts—and therefore, to pay an attorney. The statutory solution therefore appears sounder than unpredictable, potentially-unaffordable bankruptcy litigation.

Provisions affecting the automobile and auto loans. It is likely that the automobile is the most important asset for a non-homeowner who declares bankruptcy. First, in most parts of the state, people need to drive to reach their jobs, which in turn is essential to continuing to earn and avoid future debts. (To say nothing of the need to drive to school, the grocery store, to the other parent's house when child custody is shared, and so forth.) Second, if the car is lost in bankruptcy, any loss of equity reduces the debtor's ability to make a large enough down payment to avoid a large loan and a double-digit interest rate for a replacement car. The latter situation, again, is undesirable for someone seeking to rebuild their finances.

In recognition of the economic necessity of having a car in most parts of California, a certain amount of equity in an automobile is shielded from creditors – currently, under California law, \$6,375 under the 703 exemptions and \$3,625 under the 704 exemptions. (See Judicial Council Form EJ-156.) If the car is determined to be worth more than the exemption, then the debtor must sell the car and may keep the exempt amount, but must surrender the excess to creditors. This bill increases the amount of equity in an automobile that a debtor can retain to \$9,500 under both the 703 and 704 exemptions.

Most people take out loans to purchase cars. Under current California law, declaring bankruptcy automatically triggers a default on most such loan contracts. This enables the lender to repossess the car or else accelerate the loan (i.e., demand that the whole loan be immediately repaid)—even if the debtor is current on all of their monthly installment payments. This bill changes this rule, and establishes that declaring bankruptcy does not automatically trigger a default under an automobile loan. *Note that this provision does not relieve the debtor from having to continue to repay their auto loan.*

Provisions affecting health aids, including vehicles modified for people with disabilities. The 703 exemptions protect “[p]rofessionally prescribed health aids for the debtor.” The 704 exemptions protect from seizure “[h]ealth aids reasonably necessary to enable the...debtor or the spouse or a dependent...to work or sustain health,” including prosthetics and orthopedics. (Code of Civil Procedure Section 704.050.) This bill would add professionally prescribed health aids for the debtor's spouse to the 703 exemptions. It would also include in the definition of “health aids,” under both sets of exemptions, vehicles converted for use by people with disabilities, such as including a wheelchair lift or motorized steps. The ongoing need for such a vehicle for the disabled person “to work or sustain health” should be obvious.

Provisions affecting accrued sick leave, family leave, and vacation pay. One topic currently unaddressed is how much of an employee's unpaid but accrued sick leave, vacation pay, and family leave should be exempt if the employee declares bankruptcy. This bill would exempt these accrued amounts up to \$7,500 under the both the 703 and 704 exemptions. The 703 exemptions would also include wages within the \$7,500 cap.

Provisions affecting employment-related lawsuits, including for workplace discrimination and sexual harassment. This bill would include in the 703 exemptions a “payment under a settlement agreement arising out of or regarding the debtor's employment, to the extent reasonably necessary for the support of the debtor, the debtor's spouse, or a dependent of the debtor.” In other words, any settlements of wage-and-hour claims, employment discrimination and sexual harassment suits would be exempt, though only in amount “reasonably necessary” for support.

Provisions affecting insurance and other payments for death of a spouse. The 703 exemptions protect money that a debtor receives due to the death of someone on whom the debtor was dependent, to the extent reasonably necessary for their support, but not due to the death of a spouse. These include payments for wrongful death, under a life insurance contract, due to personal bodily injury, or for loss of the decedent's future earnings. (Code of Civil Procedure Section 703.140 (b)(11).) This bill would make clear that such payments, when due to the death of a spouse, are similarly exempt. This is an important provision given that, as noted above, the death of a spouse (and the accompanying loss of their income) often triggers bankruptcy.

Provisions assisting debtors whose spouses are non-cooperative or abusive. If a married person files individually for bankruptcy, rather than jointly with their spouse, then by default the 704 exemptions apply. Currently, both spouses have to consent in writing if the filer wants to elect the 703 exemptions. (Code of Civil Procedure Section 703.140 (a)(2).) This presents a challenge if the spouses are separated, particularly when they are not communicating. In the worst case, the debtor has separated from their spouse due to fear of domestic violence and cannot obtain a signature. This bill would address this problem by providing that "a waiver is not required from a debtor who is living separate and apart from their spouse as of the date the petition...is filed." (Proposed Code of Civil Procedure Section 703.140 (a)(2)(B).) There is one exception, however. Both spouses must still waive the 704 exemptions in writing if they share an interest in a homestead. This is due to what may be sizable equity in the homestead, given that the homestead exemption falls under the 704 exemptions. This carve-out prevents one spouse from using home equity to pay off their debts without the consent of the other.

Provisions affecting child and spousal support. This bill would deem "[a]limony, support, and separate maintenance, to the extent reasonably necessary for the support of the debtor and any dependent...exempt" from seizure by creditors under the 704 exemptions. (Proposed Code of Civil Procedure Section 704.111.) This protection already exists under the 703 exemptions. (Code of Civil Procedure Section 703.140 (b)(10)(D).) This provision is important given that, as discussed above, loss of a spouse's income through divorce is one of the principal drivers of bankruptcy. Note that only the amount of spousal or child support "reasonably necessary" for the debtor or dependents is exempt, meaning that lavish support is not exempt. Creditors can still seize any excess amounts that the debtor cannot prove are reasonably necessary.

ARGUMENTS IN SUPPORT: Consumer Federation of California contends that this bill furthers the aims of bankruptcy:

[Bankruptcy] allows indebted consumers to get a fresh start and rebuild their finances. Unfortunately, consumers still face several barriers to recovery throughout this process. Under current law, consumers who have not missed a car payment can still have their vehicle taken away in bankruptcy. Individuals awarded money as a result of an employment law claim, like those for sexual harassment or racial discrimination, may have to give up that award to a creditor. These are just a few of the issues that bankruptcy comes with in California. SB 1099 updates the bankruptcy code to address these issues and ensure that consumers can properly get back on their feet.

ARGUMENTS IN OPPOSITION: The California Judgment Preservation Alliance is opposed to the bill in part because, by strengthening certain of the 740 exemptions, the bill also protects property belonging to non-bankruptcy-filing debtors:

We oppose SB 1099 because, in entering judgments in favor of the judgment creditor, the courts are acknowledging it is the judgment creditors who are the victims. Enforcement of a judgment in State court is the judgment creditor's lawful right; seeking protection from enforcement of that judgment in bankruptcy court is the judgment debtor's lawful right. SB 1099 is being presented as a "bankruptcy" bill; however, it also seeks to affect laws applicable in state court, thereby affecting the enforcement of all judgments in state court.

REGISTERED SUPPORT / OPPOSITION:**Support**

National Association of Consumer Bankruptcy Attorneys (sponsor)
Consumer Federation of California

Oppose unless Amended

Trustees for Reasonable Homestead Exemption Limits

Opposition

California Association of Judgment Professionals
California Bankers Association
California Community Banking Network
California Credit Union League
California Judgment Preservation Alliance
Interwest Judgment Recovery
Judgment Recovery Alliance, LLC
Judgment Recovery of Southern California
Justice Matters
Trustees for Reasonable Homestead Exemption Limits
4 individual bankruptcy trustees

Analysis Prepared by: Jith Meganathan / JUD. / (916) 319-2334