

Memorandum 2012-10

**Third Decennial Review of Exemptions from
Enforcement of Money Judgments**

Code of Civil Procedure Section 703.120 directs the Commission to review the amounts that are exempt from the enforcement of money judgments, every 10 years:

703.120. (a) Ten years following the operative date of this title and every 10 years thereafter, the California Law Revision Commission shall review the exempt amounts provided in this chapter and in other statutes and recommend to the Governor and the Legislature any changes in exempt amounts that appear proper.

(b) Nothing in this section precludes the commission from making recommendations concerning exempt amounts more frequently than required by subdivision (a) or from making recommendations concerning any other aspect of this title, and the commission is authorized to maintain a continuing review of and submit recommendations concerning enforcement of judgments.

The decennial periods run from July 1, 1983, the operative date of the Enforcement of Judgments Law. Thus, the deadline for the third decennial review is July 1, 2013. In order to meet that deadline, the Commission should begin its work on this study in 2012.

Unless otherwise indicated, all statutory references in this memorandum are to the Code of Civil Procedure.

BACKGROUND

The Enforcement of Judgments Law, operative July 1, 1983, was enacted on Commission recommendation. See *Tentative Recommendation Proposing the Enforcement of Judgments Law*, 15 Cal. L. Revision Comm'n Reports 2001 (1980); 1982 Cal. Stat. ch. 482.

One long-standing feature of the Enforcement of Judgments Law is a set of exemptions that limit the enforcement of a money judgment. Exemptions are intended to protect an amount of property sufficient to support the judgment debtor and the judgment debtor's family and to facilitate the financial rehabilitation of the judgment debtor. See, generally, *Tentative Recommendation*

Proposing the Enforcement of Judgments Law, 15 Cal. L. Revision Comm'n Reports 2001, 2075-2100 (1980); *1982 Creditors' Remedies Legislation*, 16 Cal. L. Revision Comm'n Reports 1001, 1079-1109 (1982).

The Enforcement of Judgments Law includes two main sets of exemptions: the exemptions available when enforcing a money judgment (Section 704.010 *et seq.*; hereafter the "Section 704 general exemptions") and an alternative set of exemptions that are only available in bankruptcy (Section 703.140(b); hereafter the "Section 703 bankruptcy exemptions").

Exemptions from Enforcement of Money Judgments

There are three types of exemptions from the enforcement of a money judgment:

- (1) *Exemptions that protect personal property without regard to the monetary value of the property.* See Sections 704.020 ("ordinary and reasonably necessary" household furnishings, appliances, provisions, wearing apparel, personal effects), 704.050 ("reasonably necessary" health aids, including prostheses and orthopedic appliances). Because those exemptions are not limited to a specified dollar amount, they are not subject to degradation in value as a result of inflation. Consequently, there is no need to review the "amounts" of these exemptions.
- (2) *Exemptions that protect personal property up to a specified amount of value.* See Sections 704.010 (motor vehicle), 704.030 (residential repair materials), 704.040 (jewelry, heirlooms, and works of art), 704.060 (tools of a trade, business, or profession), 704.080 (directly deposited Social Security and public benefit payments), 704.090 (inmate trust account), and 704.100 (life insurance policy). The current dollar value for these exemptions can be found in the Exhibit.
- (3) *The "homestead exemption," which protects a specified portion of the value of real property under specified circumstances.* See Section 704.730.

Some of the exemption dollar amounts are increased if the judgment debtor is married. See Sections 704.060 (tools of a trade), 704.090 (inmate trust account), 704.100 (life insurance policy). But the general rule is that married persons are not entitled to increased or doubled exemption amounts, regardless of whether one or both of the spouses are debtors and regardless of the separate or community nature of the property. See Section 703.110(a).

Exemptions in fixed dollar amounts have the virtue of certainty and they help prevent abuse that can occur where specific items of property are exempt

without dollar limits. However, the exemption amounts may reflect political compromises between debtor and creditor interests and do not necessarily have any empirical relation to the reality of what an individual debtor needs to survive financially. Furthermore, legislatures have historically been slow to adjust exempt amounts, leading to degradation of an exemption's value over time, due to inflation.

When preparing the original Enforcement of Judgments Law, the Commission recommended increases to some fixed dollar amount exemptions to adjust for inflation. For example, in 1980 the motor vehicle exemption was \$500; the Commission recommended that it be doubled to \$1000; and as finally enacted in 1982, the exemption was set at \$1200, probably for conformity with the federal bankruptcy exemption.

The Commission also recommended the addition of Section 703.120, which requires the Commission to review the adequacy of the exemption amounts every ten years. This periodic review provides a mechanism for adjustment of the exemption amounts to keep pace with inflation.

Bankruptcy Exemptions

Federal bankruptcy law provides its own set of exemptions that are available in personal bankruptcy. See 11 U.S.C. § 522(d). However, each state may opt out of the federal exemption set, in which case its own state law judgment enforcement exemptions apply in that states' bankruptcy proceedings. See 11 U.S.C. § 522(b)(1).

California has opted out of the federal bankruptcy exemption set. See Section 703.130. This means that the Section 704 general exemptions are available in bankruptcy in California, in lieu of the federal exemption set.

However, when California opted out of the federal bankruptcy exemptions, it did something slightly unusual. It enacted the Section 703 bankruptcy exemptions, which were modeled closely after the federal bankruptcy exemptions.

A personal bankruptcy filer in California has the *option* of choosing between the Section 704 general exemption set and the alternative Section 703 bankruptcy exemption set. In effect, this gives California bankruptcy filers the best of both worlds. They can either choose the general California enforcement of judgment exemptions or an analog of the federal bankruptcy exemptions, whichever is more advantageous.

Scope of Prior Decennial Reviews

The Commission's authority is not limited to review of the exemption dollar amounts. Section 703.120(b) makes clear that the Commission also has authority to "maintain a continuing review of and submit recommendations concerning enforcement of judgments." The Commission's resolution of authority provides similarly broad authority to study "enforcement of judgments." See 2009 Cal. Stat. res. ch. 98. See also ACR 98 (Wagner) (2012).

However, the *mandatory* component of Section 703.120(a) only requires a decennial review of the "amounts" of the existing exemptions. The Commission is not *required* to consider broader issues as part of its decennial review. Historically, the Commission has not gone beyond that narrow mandate in conducting its decennial reviews. That approach was based largely on the Commission's view that any major adjustment to the equities of the exemption scheme should be addressed by the Legislature through the political process.

In its prior decennial reviews, the Commission has not made any recommendation to adjust the amount of the homestead exemption. That is because the homestead exemption receives regular legislative attention, obviating the need for Commission review. Since 1990, the homestead exemption amount has been adjusted four times. See 1990 Cal. Stat. ch. 155, § 1; 1997 Cal. Stat. ch. 82, § 1; 2003 Cal. Stat. ch. 64; 2009 Cal. Stat. ch. 499, § 2. Legislation is currently pending that would adjust the homestead exemption amount again. See AB 929 (Wieckowski).

The Commission has also not made any recommendation to change the amount of the inmate trust account exemption, as it applies to victim restitution. See Section 704.090(b). The extent to which inmate funds should be shielded from court-ordered victim restitution is fundamentally a political question that is best decided by the Legislature and the Governor.

First Decennial Review

At the time of the Commission's first decennial review in 1994, the exemption amounts had not been updated since they became operative in 1983. Between 1983 and 1994, the purchasing value of the dollar had declined by one-third or more. To account for this change in purchasing value due to inflation, the Commission recommended increases in the Section 704 general exemptions. The Commission also recommended increases in the Section 703 bankruptcy exemptions (to keep pace with the federal bankruptcy exemptions). See generally

Debtor-Creditor Relations, 25 Cal. L. Revision Comm'n Reports 1 (1995). The Commission's recommendations were enacted. See 1995 Cal. Stat. ch. 196.

Second Decennial Review

At the time of the Commission's second decennial review in 2003, the exemption amounts had not been updated since the enactment of the Commission's recommendations from the first decennial review in 1994.

The Commission again recommended that the Section 704 general exemptions be increased to account for inflation (with the exception of the homestead exemption and the exemption for victim restitution claims against inmate trust account funds). See generally *Exemptions from Enforcement of Money Judgments: Second Decennial Review*, 33 Cal. L. Revision Comm'n Reports 113 (2003). Again, the Commission's recommendations were enacted. See 2003 Cal. Stat. ch. 379.

The Commission did not recommend any changes to the Section 703 bankruptcy exemption amounts, because the Legislature had recently adjusted those amounts. See 2001 Cal. Stat. ch. 42, § 1.

In the 2001 legislation, the Legislature had also created an automatic triennial Cost of Living Adjustment (COLA) for the Section 703 bankruptcy exemptions. It did so by incorporating a COLA mechanism from federal law, which automatically updates the amounts of the federal bankruptcy exemptions. See former Section 703.140(c); 11 U.S.C. § 104(b)(1)(A). This COLA mechanism ensured that the Section 703 bankruptcy exemptions would maintain rough parity with the federal bankruptcy exemption amounts. It was therefore not necessary for the Commission to recommend any other adjustments to the Section 703 bankruptcy exemptions.

Instead, the Commission recommended that the automatic COLA approach be generalized, so that it would also apply to the Section 704 general exemption amounts. This was done by replacing former Section 703.140(c) with Section 703.150, which governs both sets of exemptions. See 2003 Cal. Stat. ch. 379, §§ 3-4. The new COLA provision did *not* apply to the homestead exemption or the exemption of inmate trust accounts from victim restitution orders.

Under Section 703.150, the Judicial Council has the responsibility of determining and publishing the triennially adjusted amounts, based on the change in the annual California Consumer Price Index for All Urban Consumers, with each adjusted amount rounded to the nearest twenty-five dollars (\$25). The \$25 rounding factor was drawn from federal law. See 11 U.S.C. § 104(b)(1)(B).

PROPOSED SCOPE OF THIRD DECENNIAL REVIEW

Consistent with the approach taken in the two prior decennial reviews, the staff recommends that the third decennial review be limited to an analysis of whether the amounts for the Section 704 general exemptions and the Section 703 bankruptcy exemptions need to be adjusted for inflation.

Because both exemption sets have been subject to a COLA mechanism for the last 10 years, the dollar amounts applicable to those exemptions should not need to be adjusted for inflation. Consequently, the focus of this memorandum is on evaluating whether the COLA mechanism has been operating properly.

REVIEW OF COLA MECHANISM

In evaluating the efficacy of the existing COLA mechanism, the staff will attempt to answer five questions:

- (1) Have the exemption amounts been adjusted according to the statutory formula?
- (2) Are the adjusted exemption amounts readily accessible to the public?
- (3) Are affected stakeholder groups satisfied with the operation of the COLA mechanism?
- (4) Does the legal literature (including appellate case law) identify any problems with the COLA mechanism?
- (5) Can we learn anything about the efficacy of the COLA mechanism from subsequent legislative developments?

Each of those questions is discussed separately below.

Have the exemption amounts been adjusted according to the statutory formula?

The staff has confirmed that the Section 704 general exemptions have been correctly adjusted pursuant to the formula specified in Section 703.150(d). This was confirmed by taking the statutory baseline amounts, applying the COLA formula for each of the scheduled adjustment periods, and comparing the result to the Judicial Council's published list of exemption amounts (Exhibit p. 1). (The staff is still evaluating the Section 703 bankruptcy exemptions. Once that evaluation is completed, the staff will report its findings.)

Note that the staff has not re-evaluated the merits of the statutory formula that is specified for the triennial adjustments. There is no reason to believe that

the statutory formula is any better or worse a measure of general inflation than any other price index that might be used.

Are the adjusted exemption amounts readily accessible to the public?

There are two main ways that the adjusted exemption amounts are disseminated to the public.

First, the Judicial Council is required to “publish” a report showing the adjusted amounts. See Section 703.150(e). The staff has confirmed that these reports are being published. A copy of the most recent report is attached as an Exhibit. This report is available for download from the Judicial Council’s website. See <<http://www.courts.ca.gov/documents/exemptions.pdf>>. It is also available in relevant secondary sources. See, e.g., California Forms of Pleading and Practice § 254.113. In addition, a general Internet search finds a number of legal service websites that link to the exemption report. See, e.g., <<http://www.nolo.com/legal-update/california-bankruptcy-exemption-amounts-increased-32503.html>>.

Second, a levying officer (typically a sheriff) must serve, among other documents, a copy of the exemption report when levying a writ of execution on a debtor who is a natural person. Code Civ. Proc. § 700.010. This provides actual notice of the most recently adjusted exemption amounts to a debtor against whom a judgment is being enforced.

The staff does not see any problem with the operation of these requirements.

Are affected stakeholder groups satisfied with the operation of the COLA mechanism?

The staff has directly solicited public comment on the effectiveness of the COLA mechanism from the following groups, all of whom have an interest in the operation of the exemptions:

- Judicial Council
- California State Sheriffs’ Association
- California Association of Collectors
- California Bankers Association
- California State Bar Insolvency Committee
- Western Center on Law and Poverty

We have not yet received any formal response from these groups. However, we are still early in the course of this study. There are still several months for interested persons and groups to weigh in.

Does the legal literature identify any problems with the COLA mechanism?

The staff could not find any case law, legal treatises, or law review articles criticizing the operation of the COLA mechanism. A general search of the Internet also failed to turn up any negative discussion of the COLA.

(The staff did find a federal bankruptcy opinion holding that California's alternative bankruptcy exemption scheme violates the supremacy clause. See *In re Regevig*, 389 B.R. 736 (Bankr. D. Ariz. 2008). However, a later appellate decision held otherwise. See *In re Applebaum*, 422 B.R. 684 (B.A.P. 9th Cir. 2009). This issue does not directly involve the dollar amounts of any specific exemptions. Rather, it involves the legitimacy of providing an alternative set of state law exemptions that is available only in bankruptcy. That issue is beyond the scope of the decennial review of exemption amounts.)

Can we learn anything about the efficacy of the COLA mechanism from subsequent legislative developments?

In 2009, the existing COLA mechanism was amended to expand its scope of application. It now applies, with one significant modification, to the homestead exemption. See 2009 Cal. Stat. ch. 499 (AB 1046 (Anderson)). The modification is that the COLA adjustment is not automatic. Instead, after Judicial Council calculates the adjusted amount, it reports that amount to the Legislature. The adjustment does not take effect without legislative approval. See Section 703.150(c).

The Legislature's reluctance to let the COLA operate automatically makes sense in light of how much larger the homestead exemption is than any of the other statutory exemptions. (The largest of the Section 704 general exemptions is currently \$14,350 (tools of the trade). See Exhibit. By contrast, the largest amount exempted by the homestead exemption is \$175,000. See Section 704.730(a)(3).)

Nonetheless, this step toward application of the COLA mechanism to the homestead exemption suggests that the Legislature is generally content with the operation and effect of the COLA mechanism. The staff could not find anything to suggest otherwise in any of the legislative analyses of the bill that added the homestead exemption to the COLA provision. Nor do those analyses identify any opposition to the bill.

CONCLUSION

We cannot yet reach any final conclusion regarding the efficacy of the COLA mechanism, because we have not yet provided a sufficient opportunity for public comment. However, based on the information that we do have, the COLA mechanism seems to be working properly. The Section 704 exemption amounts are being correctly adjusted to keep pace with inflation (we will soon be able to confirm whether the Section 703 bankruptcy amounts are also being adjusted as expected). The exemption amounts are being published and are readily available to the public from multiple sources. There is nothing in decisional law or the legal literature suggesting any problem with the fairness or operation of the COLA mechanism. Moreover, the Legislature recently saw fit to expand the use of the existing COLA mechanism, to facilitate inflation-based adjustments to the homestead exemption. This suggests general legislative satisfaction with the operation of that mechanism.

Based on all of the foregoing, it appears that the law now provides an adequate means for *automatic* adjustment of the exemption amounts over time, without the need for the Commission to periodically review those amounts and *manually* adjust them. In fact, the automatic adjustments appear to be superior to the Commission's decennial review process, because they take place at three-year intervals, rather than every 10 years. That creates less "lag" in the system, with more frequent adjustments keeping the exemption amounts closer to their intended inflation-adjusted values.

In light of the foregoing, the Commission should consider recommending the repeal of Section 703.120 (the decennial review provision) as unnecessary. If the Commission decides to do so, the staff will prepare a draft tentative recommendation for presentation at a future Commission meeting. That tentative recommendation can be used to again solicit public comment from interested persons and groups.

Respectfully submitted,

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CURRENT DOLLAR AMOUNTS OF EXEMPTIONS FROM ENFORCEMENT OF JUDGMENTS
Code of Civil Procedure sections 704.010 et seq. and 703.140(b)

EXEMPTIONS UNDER SECTION 704.010 et seq.

The following lists the current dollar amounts of exemptions from enforcement of judgment under title 9, division 2, chapter 4, article 3 (commencing with section 704.010) of the Code of Civil Procedure.

These amounts are effective April 1, 2010. They will be adjusted at each three-year interval, ending on March 31. The amount of the adjustment is based on the change in the annual California Consumer Price Index for All Urban Consumers for the most recent three-year period ending on the preceding December 31, with each adjusted amount rounded to the nearest \$25. (See Code Civ. Proc., § 703.150(c).)

<u>Code Civ. Proc. Section</u>	<u>Type of Property</u>	<u>Amount of Exemption</u>
704.010	Motor vehicle (any combination of aggregate equity, proceeds of execution sale, and proceeds of insurance or other indemnification for loss, damage, or destruction)	\$ 2,725
704.030	Material to be applied to repair or maintenance of residence	\$ 2,875
704.040	Jewelry, heirlooms, art	\$ 7,175
704.060	Personal property used in debtor's or debtor's spouse's trade, business, or profession (amount of exemption for commercial motor vehicle not to exceed \$4,850)	\$ 7,175
704.060	Personal property used in debtor's and spouse's common trade, business, or profession (amount of exemption for commercial motor vehicle not to exceed \$9,700)	\$ 14,350
704.080	Deposit account with direct payment of social security or public benefits (exemption without claim, section 704.080(b)) ¹	
	• Public benefits, one depositor is designated payee	\$ 1,425
	• Social security benefits, one depositor is designated payee	\$ 2,875
	• Public benefits, two or more depositors are designated payees ²	\$ 2,150
	• Social security benefits, two or more depositors are designated payees ²	\$ 4,300
704.090	Inmate trust account	\$ 1,425
	Inmate trust account (restitution fine or order)	\$ 300 ³
704.100	Aggregate loan value of unexpired life insurance policies	\$ 11,475

¹ The amount of a deposit account that exceeds exemption amounts is also exempt to the extent it consists of payments of public benefits or social security benefits. (Code Civ. Proc., § 704.080(c).)

² If only one joint payee is a beneficiary of the payment, the exemption is in the amount available to a single designated payee. (Code Civ. Proc., § 704.080(b)(3) and (4).)

³ This amount is not subject to adjustments under Code Civ. Proc., § 703.150.

CURRENT DOLLAR AMOUNTS OF EXEMPTIONS FROM ENFORCEMENT OF JUDGMENTS
Code of Civil Procedure sections 704.010 et seq. and 703.140(b)

EXEMPTIONS UNDER SECTION 703.140(b)

The following lists the current dollar amounts of exemptions from enforcement of judgment under Code of Civil Procedure section 703.140(b).

These amounts are effective April 1, 2010. They will be adjusted at each three-year interval, ending on March 31. The amount of the adjustment is based on the change in the annual California Consumer Price Index for All Urban Consumers for the most recent three-year period ending on the preceding December 31, with each adjusted amount rounded to the nearest \$25. (See Code Civ. Proc., § 703.150(c).)

<u>Code Civ. Proc., § 703.140(b)</u>	<u>Type of Property</u>	<u>Amount of Exemption</u>
(1)	The debtor's aggregate interest in real property or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtor or a dependent of the debtor	\$ 22,075
(2)	The debtor's interest in one motor vehicle	\$ 3,525
(3)	The debtor's interest in household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments, that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor (value is of any particular item)	\$ 550
(4)	The debtor's aggregate interest in jewelry held primarily for the personal, family, or household use of the debtor or a dependent of the debtor	\$ 1,425
(5)	The debtor's aggregate interest, plus any unused amount of the exemption provided under paragraph (1), in any property	\$ 1,175
(6)	The debtor's aggregate interest in any implements, professional books, or tools of the trade of the debtor or the trade of a dependent of the debtor	\$ 2,200
(8)	The debtor's aggregate interest in any accrued dividend or interest under, or loan value of, any unmaturing life insurance contract owned by the debtor under which the insured is the debtor or an individual of whom the debtor is a dependent	\$ 11,800
(11)(D)	The debtor's right to receive, or property traceable to, a payment on account of personal bodily injury, not including pain and suffering or compensation for actual pecuniary loss, of the debtor or an individual of whom the debtor is a dependent	\$ 22,075