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Limitations on Use of the California Homestead Exemption in Bankruptcy Cases: The Case for Following *In re Pladson*

By Jeffrey C. Wurms and Leslie A. Burton¹

Two decisions, a 1991 California Court of Appeal decision, *Spencer v. Lowery*,² and a 1993 United States District Court for the Northern District of California decision, *In re Pladson*,³ severely restricted the homestead exemption available in bankruptcy cases filed in California. Some bankruptcy courts have refused to follow the *Spencer* and *Pladson* cases, and the California Legislature ("Legislature") has passed new legislation on the use of the homestead exemption in bankruptcy. This article will explore the background and rationale of the decisions and the legislative scheme, and offer support for limiting the homestead exemption in bankruptcy cases.

I. INTRODUCTION

On November 20, 1991, the California Court of Appeal issued its opinion in *Spencer*, restricting the scope of the California automatic homestead exemption to the proceeds of money judgment execution sales. *Pladson* applied *Spencer* to bankruptcy sales and found that the automatic homestead exemption did not apply to the proceeds of such sales. Thus, bankruptcy debtors could no longer rely on California Code of Civil Procedure⁴ § 704.720⁵ to claim an exemption of \$50,000 to \$100,000⁶ in equity in a residence sold by

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²235 Cal. App. 3d 1636 (1991).

³154 B.R. 305 (N.D. Cal. 1993). *Pladson* is on appeal to the Ninth Circuit Court of Appeals. Briefs have been filed and oral arguments were held on February 11, 1994.

⁴Except for those instances where the context refers to the Bankruptcy Code (11 U.S.C.), all references to "Section" throughout this article are references to the California Code of Civil Procedure.

⁵CAL. CODE CIV. PROC. § 704.720 provides in part:

(a) A homestead is exempt from sale under this division to the extent provided in § 704.800.

(b) If a homestead is sold under this division . . . the proceeds of sale . . . are exempt in the amount of the homestead exemption provided in § 704.730.

The exemption is often referred to as the "automatic" homestead exemption to distinguish it from the declared homestead exemption found in CAL. CODE CIV. PROC. §§ 704.910-704.995.

a bankruptcy trustee. The debtor could rely only on section 703.140(b)(1) to claim an exemption of up to \$7,500⁷ of equity in a residence.

II. TWO CHOICES, THEN TWO CHOICES AGAIN: THE FEDERAL AND CALIFORNIA HOMESTEAD EXEMPTIONS

A. FEDERAL BANKRUPTCY LAW GIVES A BANKRUPTCY DEBTOR A CHOICE BETWEEN TWO HOMESTEAD EXEMPTIONS

The current Bankruptcy Code exemption scheme (in relevant part unchanged since enacted in 1978) is found in Bankruptcy Code § 522 and gives bankruptcy debtors a choice between two sets of exemptions.⁸ The debtor has a choice between exempting his property under the federal bankruptcy exemptions set forth in section 522(d) ("federal bankruptcy exemptions"), which include a \$7,500 homestead exemption, or other nonbankruptcy-specific exemptions available under local, state, and federal law ("nonbankruptcy exemptions").⁹ Whether nonbankruptcy exemptions contain a homestead exemption depends on the law adopted by the bankruptcy debtor's state of residence, but the Bankruptcy Code does not require such an exemption.¹⁰

Section 522(b)(1) gives each state the right to "opt out" of the federal bankruptcy exemptions and to limit state residents to the nonbankruptcy exemptions available to them.¹¹ Upon "opt out," the state exemptions are applied in bankruptcy just as they are applied outside of bankruptcy.¹²

⁶(... continued)

⁶CAL. CODE CIV. PROC. § 704.730(a). It is incorrect for bankruptcy debtors to exempt their residence using § 704.730. The section does not create an exemption, but only states the amount of the homestead exemption created by § 704.720(b). *Redwood Empire Production Credit Association v. Anderson (In re Anderson)*, 824 F.2d 754, 758 (9th Cir. 1987).

⁷A bankruptcy debtor may increase the exemption from \$7,500 to \$7,900. CAL. CODE CIV. PROC. § 703.140(b)(5).

⁸*Bloom v. Robinson (In re Bloom)*, 839 F.2d 1376, 1378 (9th Cir. 1988); *Daniel v. Security Pacific National Bank (In re Daniel)*, 771 F.2d 1352, 1355 (9th Cir. 1985).

⁹11 U.S.C. § 522(b)(1) provides in part:

(b) [A]n individual debtor may exempt from property of the estate the property listed in either paragraph (1) or, in the alternative, paragraph (2) of this subsection . . . Such property is—

(1) property that is specified under subsection (d) of this section. . . .

(2) [A]ny property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition . . .

¹⁰*Owen v. Owen*, 111 S. Ct., 1833, 1835 (1991); *Pitrat v. Gartikov*, 947 F.2d 419, 429 (9th Cir. 1991) *withdrawn on other grounds* 992 F.2d 224 (9th Cir. 1993); *England v. Golden (In re Golden)*, 789 F.2d 698, 700 (9th Cir. 1986).

¹¹789 F.2d at 700.

¹²*In re Schneider*, 9 B.R. 488, 490 (N.D. Cal. 1981); *see Owen*, 111 S. Ct. at 1835; *Pitrat*, 947 F.2d at 429; *Golden*, 789 F.2d at 700.

The Courts may not expand the scope of the exemptions, except when avoiding a lien under Bankruptcy Code § 522(f).¹³ The limited authority to expand is a direct derivative of the language of Bankruptcy Code § 522(f). No other section of the Bankruptcy Code contains similar language which would support expanding the exemptions to of bankruptcy sales. When a bankruptcy sale is conducted, the court must apply the debtor's exemptions as they exist under Bankruptcy Code § 522(b), instead of hypothesizing what the exemptions "would have been" for purposes of Bankruptcy Code § 522(f).

In 1984, California chose to "opt out."¹⁴ California residents, therefore, can exempt property only under California and federal nonbankruptcy exemption laws, including the California homestead exemption of section 704.720.

**B. CALIFORNIA LAW GIVES BANKRUPTCY DEBTORS
THE IDENTICAL HOMESTEAD EXEMPTION
ENJOYED BY JUDGMENT DEBTORS UNDER SECTION 704.720
WITHOUT EXPANDING ITS SCOPE**

**1. The Exemptions Apply In Bankruptcy
The Same As Under State Law**

A recent case¹⁵ critical of *Spencer* and *Pladson* interpreted section 703.140(a)¹⁶ as a vehicle for expanding the scope of the nonbankruptcy exemptions as authorized by

¹³11 U.S.C. § 522(f) provides for the avoidance of judicial liens and nonpossessory nonpurchase money security interests in certain property to the extent that the liens and interests impair an exemption which the debtor "would have been entitled" to claim. In *Owen*, 111 S. Ct. at 1835, the court held that although a Florida exemption protecting homesteads from forced sales did not include the debtor's residence, the debtor was entitled nevertheless to avoid a judgment lien on the residence. The Court recognized that under Florida law the residence was not exempt and that its holding expanded the exemption. The Court found, however, that the specific language of Bankruptcy Code § 522(f), which allows the debtor to avoid interest in property to which the debtor *would have been* entitled, expressly authorized the expansion. 111 S.Ct. at 1836-37. The Court reasoned that this language denotes a hypothetical state of affairs warranting avoidance of a lien because if the lien had not been recorded, the debtor could have exempted the residence under Florida law.

¹⁴CAL. CODE CIV. PROC. § 703.130.

¹⁵*In re Norman*, 157 B.R. 460, 463 (Bankr. C.D. Cal. 1993). *Norman* is on appeal to the Ninth Circuit Bankruptcy Appellate Panel. The parties have requested a stay of the proceedings pending the Ninth Circuit's decision in *Pladson*.

¹⁶CAL. CODE CIV. PROC. § 703.140(a), before its October 1993 amendment provided:

(a) If a petition is filed under Title 11 of the United States Code, the exemptions provided by this chapter other than the provisions of subdivision (b) of this section shall be applicable, but the exemptions provided by subdivision (b) may be elected in lieu of all other exemptions provided by this chapter

Except for the last section which discusses amended § 703.140, this article will focus on § 703.140 as it existed at the time of the *Pladson* decision.

section 703.010.¹⁷ This position is not supported by the text of the statute or its legislative history.

Section 703.140 states that when a debtor files a bankruptcy petition, the California nonbankruptcy exemptions "shall be applicable." The word "applicable" is a form of "to apply." "Apply" is used when referring to the process by which a statute is made operative.¹⁸ It would be contrary to the plain meaning of the term "apply" to hold that "applying" exemptions means "expanding" exemptions in bankruptcy instead of simply making them operative. Bankruptcy debtors, therefore, can exempt only property which a judgment debtor can exempt. Anything more would be an expansion of section 704.720 through section 703.140.

Section 703.140's legislative history is consistent with the plain meaning of applying the state exemptions as they are and clearly shows that the statute was not enacted to expand their scope. The sole purpose of section 703.140 was to prohibit the practice of "stacking"¹⁹ by eliminating the California bankruptcy debtors' right to claim the federal bankruptcy exemptions. A statute passed to limit bankruptcy debtors' exemption options logically cannot be used as a basis to expand the scope of the exemptions. The Legislature reiterated in section 703.140(a) that bankruptcy debtors have the right to exempt their property under state, local, and federal nonbankruptcy law. If it wished to expand that right, it could have done so explicitly. In fact, the Ninth Circuit has recognized that exemptions should not be expanded but should be applied in bankruptcy as they exist under state law.²⁰

¹⁷When it enacted the exemptions, the Legislature originally restricted them to judgment debtors. The Legislature also enacted CAL. CODE CIV. PROC. § 703.010, which provides that the scope of the exemptions may be statutorily expanded beyond the enforcement of money judgments. Section 703.010 provides:

Except as otherwise provided by statute:

(a) The exemptions provided by this chapter or by any other statute apply to all procedures for enforcement of a money judgment.

(b) The exemptions provided by this chapter or by any other statute do not apply if the judgment to be enforced is for the foreclosure of a mortgage, deed of trust, or other lien or encumbrance on the property other than a lien created pursuant to this division or pursuant to Title 6.5 (commencing with § 481.010) (attachment).

¹⁸BLACK'S LAW DICTIONARY (6th ed. 1990).

¹⁹Baldwin v. Marshall (*In re Baldwin*), 70 B.R. 612, 615 (9th Cir. BAP 1987), citing Calif. Legislature Senate Comm. on Judiciary, Selected Bill Analysis, vol. 3, p. 2; *In re Petruzzelli*, 139 B.R. 241, 244 (Bankr. E.D. Cal. 1992) ("[Section 703.140] was enacted because California wished to permit debtors to have the benefit of the federal bankruptcy exemptions while precluding joint debtors from the much-criticized practice of "stacking" in which one spouse would claim federal exemptions and the other spouse would claim state exemptions, thereby reaping the best for both. . . . [A]fter banning "stacking," [the Legislature] enacted the federal bankruptcy exemptions under the guise of state law."); see *In re Lennen*, 71 B.R. 80, 71-82 (Bankr. N.D. Cal. 1987).

²⁰*Schneider*, 9 B.R. at 490; see *Talmadge v. Duck* (*In re Talmadge*), 832 F.2d 1120, 1123 (9th Cir. 1987); *Golden*, 789 F.2d at 700; *Petruzzelli*, 139 B.R. at 244; 1992 Creditors' Remedies Legislation, 16 Cal. L. Revision Comm'n Reports 1001, 1098-99 (1982).

2. Treating Bankruptcy Sales and Execution Sale As Equivalents Would Expand the Exemption

Nothing in either the text of section 703.140(a), nor in its legislative history, indicates that it transforms a bankruptcy sale into an execution sale. In fact, such a holding would be contrary to the Ninth Circuit's holding that a bankruptcy trustee's power of sale is distinct from the power of a judgment creditor under California law.²¹

3. Section 704.720 and the Other Nonbankruptcy Exemptions Continue to Have Validity in Bankruptcy Cases

Pladson does not leave section 703.140(a) or the nonbankruptcy exemptions with no effect in bankruptcy cases, as one recent case maintains.²² Admittedly, section 703.140 is not necessary to allow bankruptcy debtors to exempt the property found in the nonbankruptcy exemptions; that is the function of Bankruptcy Code § 522(b).²³ Instead, section 703.140(a) authorizes bankruptcy debtors to choose between the nonbankruptcy exemptions available to judgment debtors or a different set of exemptions found in section 701.140(b) and available only to bankruptcy debtors, and through its interaction with section 703.110 prohibits married debtors from choosing both.²⁴ Section 703.140(a) does not expand the section 704.720 exemption beyond execution sales proceeds. After *Pladson*, the section 704.720 homestead exemption still applies in bankruptcy cases, and may be used when a money judgment is enforced prepetition and surplus execution sale proceeds become property of a bankruptcy estate, or when a debtor seeks to avoid a lien.

²¹*Schwaber v. Reed (In re Reed)*, 940 F.2d 1317, 1322 n.7 (9th Cir. 1991) (the court rejected the motion that a bankruptcy trustee's power to sell is limited by law to the same extent as a judgment creditor's power to sell).

²²*Norman*, 157 B.R. at 463, 465.

²³*Norman*, 157 B.R. at 463.

²⁴At least one court has found § 703.140 unconstitutional, holding that the Legislature violated the uniformity clause by creating a set of California bankruptcy exemptions, when the only power given to the states was to "opt out" of the federal bankruptcy exemption. *Lennen*, 71 B.R. at 82.

**III. BECAUSE SECTION 704.720 LIMITS
A BANKRUPTCY DEBTOR'S HOMESTEAD EXEMPTION
TO PROCEEDS OF A RESIDENCE SOLD BY EXECUTION SALE,
THE EXEMPTION DOES NOT APPLY TO BANKRUPTCY SALES**

**A. SPENCER PROPERLY USED THE CANONS
OF STATUTORY CONSTRUCTION
TO INTERPRET SECTION 704.720.**

**1. Using the Plain Meaning of Section 704.720,
the Court of Appeal in *Spencer* Defined the Scope
of the Homestead Exemption to Include
Only the Proceeds of an Execution Sale of a Residence**

In the *Spencer* case,²⁵ the California Court of Appeal defined the scope of the California nonbankruptcy homestead exemption under section 704.720(b).

The *Spencer* court examined the language of section 704.720(b),²⁶ and noted that it gave a homestead exemption in the proceeds of a residence "sold under this division." The court found "this division" to be a clear, unambiguous reference to Division 2 of Title 9 of the California Code of Civil Procedure, a division devoted exclusively to the enforcement of money judgments. Thus, it held that only the proceeds of sales to enforce money judgments (execution sales), not all forced sales, are exempt under section 704.720(b). "There is nothing ambiguous or uncertain in § 704.720(b) which would require us to examine any policy concerns or legislative history. *Since defendants' property was not sold in execution of a money judgment, they are not entitled to the statutory homestead exemption.*"²⁷

Spencer properly relied on the statute's plain meaning. The policy of interpreting a statute by its plain meaning is strong, and courts will refrain from usurping the legislative function, especially in the area affecting the balance between a debtor's fresh start and creditors' rights. The Ninth Circuit has reiterated this policy in three recent cases: *Cheng*

²⁵The Spencers were judgment debtors (not in bankruptcy) who lost their residence through a nonjudicial foreclosure sale (a sale under a power of sale clause in a deed of trust). At the foreclosure sale, a third party purchased the residence for more than the demand amount, creating a surplus. The Spencers and a judgment lienholder argued over the disposition of the surplus, each of them claiming entitlement to it. The Spencers argued that the § 704.720 exemption encompassed all forced sales, and that the proceeds of a nonjudicial foreclosure sale were proceeds of a forced sale entitled to exemption under that section. Although the trial court agreed with the Spencers and allowed the exemption, the California Court of Appeal reversed.

²⁶*Droeger v. Friedman, Sloan & Ross*, 54 Cal. 3d 26, 38 (1991) (when a statute's language is clear, its plain meaning should be followed despite the acknowledged hardship it would impose); *Moyer v. Workmen's Comp. Appeals Bd.*, 10 Cal. 3d 222, 230 (1973) (to effectuate the purpose of the law, the court first should examine the language of the statute).

²⁷235 Cal. App. 3d 1638 (emphasis added). The *Spencer* court nevertheless examined the legislative history of CAL. CODE CIV. PROC. § 704.720 and found that it was not contrary to the statute's plain meaning. As long as the plain meaning of a statute is consistent with some legislative history, it must be applied. *People v. Belleci*, 24 Cal. 3d 879, 884-86 (1974); *People v. Boyd*, 24 Cal. 3d 285, 294-97 (1979).

v. Gill (In re Cheng),²⁸ *Beezley v. California Land Title Company (In re Beezley)*,²⁹ and *City National Bank v. Chabot (In re Chabot)*.³⁰

The court in *Spencer* followed the plain meaning of section 704.720(b), correctly declining to rewrite the California Legislature's exemption scheme or broaden its scope.³¹ In so doing, it followed the weight of judicial authority.

2. Legislative History Supports *Spencer's* Interpretation

a. A 1983 Change in Exemption Law Repealed the Only Provision Allowing an Exemption in Bankruptcy Sales

The legislative history of section 704.720 supports applying *Spencer's* plain meaning interpretation in bankruptcy cases.

Until recently, the bankruptcy debtor's residence was exempt from bankruptcy sales under California homestead law.³² Previous California Civil Code § 1240³³ exempted the residence from both execution and forced sales.³⁴ Civil Code §§ 1256 and 1257 exempted

²⁸943 F.2d 1114 (9th Cir. 1991). In *Cheng*, the Ninth Circuit held that a debtor who was the sole owner of his corporation was entitled to exempt his interest in the corporation's retirement plan under the plain meaning of CAL. CODE CIV. PROC. § 704.115. The court reasoned:

Although the legislative history indicates that the policy behind section 704.115(e) is to limit the exemption for plans that are controlled by one person, the statute says what it says, and it was improper for the bankruptcy court to read beyond it . . . We recognize the odd result the statute creates . . . but we may not disregard the statute's language to address problems properly left to the legislature.

at 1117.

²⁹94 F.2d 1433 (9th Cir. 1993). In *Beezley*, the Ninth Circuit addressed the issue of whether a debtor's case should be reopened to discharge a debt. Finding that the clear language of § 523(a) was not an aberration, but a Congressional policy choice, the court rejected the creditor's attempts to look beyond the plain meaning of the statute. "How to strike that balance between the rights of creditors and debtors] is an inordinately difficult question—a question of public policy Our task is, perhaps, a relatively easier one, for we have only to apply the law as Congress has written it." *Id.* at 1439-40.

³⁰92 F.2d 891 (9th Cir. 1993). In *Chabot*, the Ninth Circuit rejected an interpretation of 11 U.S.C. § 522(f) with reference to the "fresh start" policy, applying instead the statute's plain meaning. *Id.* at 894-895.

³¹*Anderson*, 824 F.2d at 759; *Security First Nat. Bk. v. Pierson*, 2 Cal. 2d 63, 65 (1934); *Berhanu v. Metzger*, 12 Cal. App. 445, 448 (1992).

³²*Taylor v. Madigan*, 53 Cal. App. 3d 943, 957, 959 n.11 (1975) (the homestead exemption is purely of statutory origin with no roots in common law. From the time that the § 1240 homestead exemption was adopted in 1872 until its amendment in 1983, the homestead exemption remained virtually unchanged).

³³CAL. CIV. CODE § 1240 provided: The homestead is exempt from execution or forced sale, except as in this Title provided.

³⁴Not all forced sales are execution sales for purposes of the homestead exemption. For instance, a sale in an action to partition is a type of forced sale which is not an execution sale. See *Kaupe v. Kaupe*, 131 Cal. App. 2d 511, 514 (1955); *Walton v. Walton*, 59 Cal. App. 2d 26 (1943).

the proceeds of execution and forced sales of homesteads.³⁵ Because bankruptcy sales are forced sales, the exemptions applied to them.

In 1983, while revising the laws relating to the enforcement of judgments and related exemptions, the Legislature changed the homestead exemption.³⁶ The homestead exemptions previously contained in Civil Code §§ 1240 and 1256 were repealed, superseded, and replaced by section 704.720.³⁷ A review of section 704.720's language and related legislative comments and statutes indicates that the section 704.720 homestead exemption does not apply to bankruptcy sales.

In section 704.720, the Legislature removed the language allowing a homestead exemption in all forced sale proceedings (including bankruptcy sales), and retained only the language allowing the exemption against execution sales. The legislative comment unequivocally states that the homestead exemption will apply only to execution sales.³⁸ Certainly, there is no presumption that the homestead exemption for forced sales survived the revision.³⁹ This deliberate omission of the term "forced sales" by the Legislature may not be ignored by a court interpreting the statute.⁴⁰

In California, it is presumed that each word, phrase, or provision of a statute has meaning and performs a useful function.⁴¹ Applying section 704.720 to bankruptcy sales,

³⁵CAL. CIV. CODE §§ 1256 and 1257 (known respectively as CAL. CIV. CODE §§ 1255 and 1256 from the time of their 1979 revision until their 1983 repeal) applied to execution and forced sales. *Chase v. Bank of America*, 227 Cal. App. 2d 259 (1964).

³⁶"Existing law contains an extensive and comprehensive statutory scheme relative to the enforcement of judgments in civil actions, including specific provisions on execution of judgments. . . This bill would repeal the above provisions and, instead, would enact a new comprehensive statute governing the enforcement of judgments. This bill would continue many of the existing provisions and features of existing law, but would also enact numerous changes." *Petruzzelli*, 139 B.R. at 242 n.2, citing 1982 Cal. Legis. Summary Digest of Statutes Enacted And Resolutions Adopted, at 490 (emphasis added); *Anderson*, 824 F.2d at 755, 761 (finding the revisions minor in the sense that debtors were not completely deprived of a homestead exemption, the court acknowledged that the revisions substantially altered the homestead exemption).

³⁷CAL. CIV. CODE §§ 1237-1304 relating to the declared homestead were repealed and superseded by CAL. CODE CIV. PROC. §§ 704.710-704.850 and 704.910-704.990. Stats. 1982, c. 497, § 8, operative July 1, 1983; Legislative Committee Comment-Senate 1982 Repeal. Additionally, Subdivision (1) of § 704.720 supersedes former CIV. CODE § 1240 and portions of former CIV. CODE § 1256. CAL. CODE CIV. PROC. § 704.720 Legislative Committee Comment—Senate 1982 Addition.

³⁸"[Subdivision (a)] does not apply where a lien on the property other than an enforcement lien is being foreclosed. . . Subdivision (b) provides an exemption for proceeds of an execution sale of a homestead." CAL. CODE CIV. PROC. § 704.720 Legislative Committee Comment-Senate 1982 Addition.

The comment also refers to voluntary sales, but the reference simply distinguishes the automatic homestead exemption from the exemption for voluntary sales under CAL. CODE CIV. PROC. §§ 704.910-704.995.

³⁹*Compare Union Bank v. Wolas*, 112 S.Ct. 527, 532 & n.15 (1991) (when a statutory scheme is repealed and revised to include substantial changes, an assumption that the legislature intended the new scheme to preserve pre-existing law is incorrect) with *Dewsnup v. Timm*, 112 S. Ct. 773, 779 (1992) (Court considered legislative silence as an indication that pre-revision law survived when the new language was ambiguous).

⁴⁰*Talmadge*, 832 F.2d at 1124 (9th Cir. 1987); *People v. Valentine*, 28 Cal. 2d 121, 142 (1946).

⁴¹*Talmadge*, 832 F.2d at 1123; *Gay Law Students Assn. v. Pacific Tel. & Tel. Co.*, 24 Cal. 3d 458, 478 (1979); *Clements v. T. R. Bechtel Co.*, 43 Cal. 2d 227, 233 (1954); *Smith v. Rhea*, 72 Cal. App. 3d 361, 370 (1977).

which are not execution sales under Division 2, would improperly make the phrase "under this division" superfluous.

b. Related Statutes Support Pladson's Denial of the Homestead Exemption to Bankruptcy Sales

The Legislature's intent to limit section 704.720 to proceeds of execution sales is also gleaned from the language of related exemption statutes.⁴² The Legislature made a clear distinction between the section 704.720 exemption and other exemptions.

Only section 704.720 exempts "proceeds" of an execution sale. No other exemption of tangible property refers solely to proceeds or requires that equity first be converted into proceeds by a particular type of sale; instead they exempt "equity," "interest," or "value," descriptions which apply with equal force to all types of sales. "Equity" and "proceeds" are not synonymous terms, and any other interpretation of section 704.720 would ignore the defined and accepted definitions of and differences between those terms.⁴³ Certainly, the Legislature could have drafted section 704.720 more like the other exemptions, avoiding the "sale under this division" language and exempting the "value of" or "equity in" the property instead of the "proceeds." Its failure to do so must be regarded as intentional.⁴⁴

Another related exemption statute, section 703.010,⁴⁵ gives further support for the position that section 704.720 does not apply to bankruptcy sales. Section 703.010 affirmatively limits the use of the exemptions in its chapter, which includes section 704.720, to proceedings to enforce specific types of money judgments. It does not include all forced sales or bankruptcy sales.

⁴²When one statute contains a provision, the omission of that provision from a related or similar statute is significant to show that a different intention existed. *Penasquitos, Inc. v. Superior Court*, 33 Cal.3d 1180, 1188-89 (1991); *Clements*, 43 Cal. 2d at 232; *Valentine*, 28 Cal. 2d at 142; *Smith*, 72 Cal. App. 3d at 367-68 (when language regarding payment of execution sales proceeds appeared in one exemption statute but not another, the omission was indicative of legislative intent).

⁴³"Equity" means the fair market value of the interest of the judgment debtor in property, . . . over and above all liens and encumbrances on the interest superior to the judgment creditor's lien. CAL. CODE CIV. PROC. § 680.190.

"Proceeds" means things of value arising or obtained by the sale of property. BLACKS LAW DICTIONARY, 6th ed.; see also CAL. CODE CIV. PROC. § 697.620; CAL. COMM. CODE § 9306; CAL. CIV. CODE § 2225; CAL. FOOD & AG. CODE §§ 403, 57505, 57554.

⁴⁴*People v. Drake*, 19 Cal.3d 749, 755 (1977) ("When a statute, with reference to one subject contains a given provision, the omission of such provision from a similar statute concerning a related subject is significant to show that a different intention existed!" (quoting *People v. Valentine*, 28 Cal.2d 121, 142 (1946))).

⁴⁵See note 17, *supra* (text of CAL. CODE CIV. PROC. § 703.010).

c. Legislative Inaction Does Not Indicate Legislative Intent

At least one court⁴⁶ has argued that the Legislature must intend for bankruptcy debtors to exempt their homesteads under section 704.720 because the Legislature has not revised sections 703.140(a) or 704.720 to prevent the practice. Legislative inaction, however, does not indicate legislative approval.⁴⁷

B. FEDERAL COURTS ARE BOUND BY SPENCER'S INTERPRETATION OF SECTION 704.720 AND MUST APPLY IT IN BANKRUPTCY

Federal courts are bound in bankruptcy cases by relevant California cases interpreting the homestead exemption.⁴⁸ When a California Court of Appeal rules on an exemption issue, federal courts must apply that rule absent a contrary ruling by the California Supreme Court.⁴⁹ Only if the federal court finds convincing evidence that the California Supreme Court would decide differently may it refuse to follow the Court of Appeal decision.⁵⁰ Because *Spencer* employed the proper rules of statutory construction, there is no such evidence.⁵¹

Before *Spencer*, there was no binding state court decision and it was appropriate for the federal courts to interpret section 704.720. With the filing of the *Spencer* decision, however, previous federal interpretations were superseded and the federal courts became bound to follow *Spencer*.⁵²

⁴⁶*In re Donaldson*, 156 B.R. 51, 53 (Bankr. N.D. Cal. 1993).

⁴⁷*People v. King*, 5 Cal. 4th 59, 75, 77 (1993) (the legislative failure to address a court's interpretation of a statute does not imply legislative approval because its failure may be attributable to many things unrelated to the merits of the court's interpretation, e.g., the pressure of other and more important business, political considerations, or a tendency to trust to the courts to correct their own errors).

⁴⁸*Anderson*, 824 F.2d at 756; see also *Page v. Edmunds*, 23 S. Ct. 200, 202 (1902) (federal court must yield to state court cases interpreting state statutes); *Hyman v. Plotkin (In re Hyman)*, 123 B.R. 342, 344 (9th Cir. BAP 1991) (California state law controls substantive questions involving homestead exemption rights); *In re Frost*, 111 B.R. 306, 310 (Bankr. C.D. Cal. 1990) (bankruptcy court is bound by state court interpretation that tax liens are subject to state exemptions).

⁴⁹*Compare State Farm Fire and Casualty v. Abrio*, 874 F.2d 619 (9th Cir. 1989) (case involving issue decided by the California Court of Appeal, but not by the California Supreme Court) with *Ulvestad v. Chevron U.S.A., Inc.*, 818 F. Supp. 292 (C.D. Cal. 1993) (case involving issue never previously addressed by either California Supreme Court or California Court of Appeal).

⁵⁰*State Farm*, 874 F.2d at 621; *Klingebiel v. Lockheed Aircraft Corporation*, 494 F.2d 343, 346 n.2 (9th Cir. 1979).

⁵¹Although two California Court of Appeal cases, *Little v. Community Bank*, 235 Cal. App. 3d 355 (1991) and *Webb v. Trippet*, 235 Cal. App. 3d 647 (1991), refer to forced sales in *dicta* when discussing the application of the exemption under CAL. CODE CIV. PROC. § 704.720, the discussions are inapplicable here because the cases involved execution sales and the courts had no reason to distinguish the two types of sales for purposes of applying the exemption.

⁵²*Anderson*, 824 F.2d at 759 (federal courts do not have a license to rewrite the California legislature's exemption scheme or to broaden its scope); *Schneider*, 9 B.R. at 940 (state court decision should guide exemption interpretations.)

Some courts critical of *Spencer* and *Pladson* have asserted that *Spencer's* holding that the exemption applies only to execution sale proceeds is *dictum*,⁵³ or that *Spencer* does not apply in a bankruptcy context.⁵⁴ These assertions do not withstand scrutiny.

The issue in *Spencer* was whether section 704.720 allowed debtors to exempt the proceeds of all forced sales, and specifically proceeds of a nonjudicial foreclosure sale. In its analysis, the *Spencer* court compared section 704.720 to the related provisions of section 703.010(b).⁵⁵ Section 703.010 discusses *judicial* foreclosure sales while *Spencer* involved a *nonjudicial* foreclosure sale.⁵⁶ If section 703.010(b) were dispositive, the court would not have provided a detailed analysis of section 704.720(b).

The *Spencer* court used section 703.010(b) to illustrate that including all forced sales within the ambit of "sale(s) under this division" as used in section 704.720(a) would create the absurd result of prohibiting foreclosure sales unless the sale price satisfied all encumbrances and the homestead exemption. Because foreclosure sales are not so limited, "sale under this division" could not mean all forced sales.⁵⁷ *Spencer's* holding is sound.

Moreover, an argument that *Spencer* should not be followed because it does not define the scope of the homestead exemption in a bankruptcy context has been rejected. To hold otherwise would render most state court interpretations of its exemption statutes meaningless in bankruptcy cases.⁵⁸

⁵³*Norman*, 157 B.R. at 465 (asserts that *Spencer* was not based on § 704.720, but on § 703.010(b)).

⁵⁴*Donaldson*, 156 B.R. at 53 (asserts that *Spencer* stands for the narrow proposition that the § 704.720 homestead exemption does not apply to foreclosure sales).

⁵⁵See note 17, *supra*.

⁵⁶Nonjudicial foreclosure sales are governed by CAL. CODE CIV. PROC. §§ 2924-2924k. Judicial foreclosure sales are governed by CAL. CODE CIV. PROC. §§ 725a-730.5. The former is a "private sale," the latter is an "execution sale." Coppola v. Superior Court, 211 Cal. App. 3d 848, 873, *rehrg. denied* (1989).

⁵⁷235 Cal. App. 3d at 1638-1639.

⁵⁸*Schneider*, 9 B.R. at 491.

**C. A SALE BY A BANKRUPTCY TRUSTEE IS NOT
AN EXECUTION SALE AND IS NOT SUBJECT
TO THE SECTION 704.720 HOMESTEAD EXEMPTION**

Although *Spencer* first held that the section 704.720 exemption applies to the proceeds of execution sales only,⁵⁹ *Pladson* was the first court to combine the two principles that (1) section 704.720 only applies to execution sales and (2) a sale by a bankruptcy trustee is not an execution sale, and therefore to conclude that section 704.720 does not apply to bankruptcy sales.

In *Pladson*, the bankruptcy debtors claimed a \$52,000 exemption in their residence under section 704.720(b). The trustee objected on the grounds that the residence would not be sold by execution sale and that section 704.720(b) did not exempt proceeds of a bankruptcy sale. The *Pladson* court, recognizing that bankruptcy sales were not execution sales, agreed with the trustee and disallowed the exemption.⁶⁰

Pladson followed the firm weight of Ninth Circuit and California law which holds that bankruptcy sales are not execution sales.⁶¹ Similarities between the two types of sales do not eliminate their distinctions.⁶²

Despite the recognized distinction between bankruptcy and execution sales, two recent cases have held that they are equivalent.⁶³ These cases incorrectly apply Bankruptcy Code §§ 544 and 522(f).

A bankruptcy trustee sells the estate's property under Bankruptcy Code § 363, pursuant to his bankruptcy powers, not as a judgment creditor under Bankruptcy Code §

⁵⁹Because *Spencer* involved a trust deed sale, it was not called upon to decide whether bankruptcy sales are the same as execution sales.

⁶⁰*Pladson*, 154 B.R. at 306-307.

⁶¹*Ewell v. Diebert (In re Ewell)*, 958 F.2d 276 (9th Cir. 1992); *Reed*, 940 F.2d 1317 (9th Cir. 1991); *In re Transcontinental Energy Corp.*, 683 F.2d 326 (9th Cir. 1982); *In re CADA Inv., Inc.*, 664 F.2d 1158 (9th Cir. 1981); *Travelers Ins. Co. v. Lawrence*, 509 F.2d 83 (9th Cir. 1974); *Coppola v. Superior Court*, 211 Cal. App. 3d 848 (1989). See also *In re Met-L-Wood Corp.*, 861 F.2d 1012 (7th Cir. 1988), cert. denied, 109 S. Ct. 1642 (1988).

⁶²In *Hyman*, 967 F.2d 1316, the court compared an execution sale to a bankruptcy sale while addressing the issue of whether the debtor could reap the benefit of postpetition appreciation. The issue crystallized the distinction between exemptions in the proceeds of execution sales and bankruptcy sales. The issue of appreciation never arises with an execution sale, yet it does in bankruptcy sales because the debtor's property may appreciate between the time the exemption is claimed and the time of sale. The court resolved the appreciation problem in bankruptcy by holding that the exemption would, as in execution sales, be applied on the sale date. If the sales were identical, however, there would have been no need to compare the two.

⁶³*Norman*, 157 B.R. at 466; *Donaldson*, 156 B.R. at 54.

544.⁶⁴ Bankruptcy sales are judicial sales,⁶⁵ not execution sales,⁶⁶ because unlike execution sales, no levy or seizure of property is necessary for the trustee to complete the sale.⁶⁷ The mere availability of the power to sell as a judgment creditor does not mean that bankruptcy sales conducted pursuant to separate independent powers must also be considered execution sales.⁶⁸ The authors are unaware of any published cases involving the sale of property under Bankruptcy Code § 544.

Some courts have employed the fiction of treating the filing of a bankruptcy petition as an execution sale for purposes of lien avoidance under Bankruptcy Code § 522(f),⁶⁹ as well as in the determination of a trustee's rights vis-a-vis the debtor.⁷⁰ Attempts to use this same fiction to defeat the trustee's rights to property based on his dual status as a judgment creditor have been rejected by the Ninth Circuit.⁷¹ In fact, the Ninth Circuit implicitly rejected the fiction when it stated that a debtor's right to use his exemption comes into play not at the filing of a petition (which it would if the fiction were employed), but only if and when the trustee attempts to sell the property.⁷² The use of the fiction against creditors, but not against trustees, is logical.⁷³

⁶⁴*Reed*, 940 F.2d at 1322-23 & n.7. Although 11 U.S.C. § 544, which gives a bankruptcy trustee the powers of a judgment creditor, might be read to allow a trustee to sell the estate's property as a judgment creditor, such a sale would be inconsistent with § 544's purpose: to allow the trustee to marshal assets or recover property which the trustee cannot recover under other avoiding powers. See *In re Johnson*, 28 B.R. 292, 297 (Bankr. N.D. Ill. 1983); 4 COLLIER ON BANKRUPTCY §544.01 at 544-2 (15th ed. 1993).

⁶⁵*Coppola*, 211 Cal. App. 3d at 872 (sales pursuant to 11 U.S.C. § 363 conducted with court approval are judicial sales).

⁶⁶*Ewell*, 958 F.2d at 280 (for purposes of FED. R. BANKR. P. 7062, a bankruptcy sale is a judicial sale, not an execution sale or enforcement of judgment); *Reed*, 940 F.2d, at 1322 n.7 (distinguishing between a bankruptcy sale and an execution sale in the context of the ability to sell a debtor's residence); see also *Transcontinental*, 683 F.2d at 328 (refers to bankruptcy sales as judicial sales); *CADA Investments*, 664 F.2d at 1162 (refers to bankruptcy sales as judicial sales).

⁶⁷*Ewell*, 958 F.2d at 280; *Travelers Ins. v. Lawrence*, 509 F.2d at 89 (although both judicial sales and execution sales are forced sales, they are distinguishable); *Transcontinental*, 683 F.2d at 328; see *Owen*, 111 S. Ct. at 1835 (debtors' residences become property of the estate by operation of 11 U.S.C. § 541).

⁶⁸*Cf. Greene v. Franchise Tax Board*, 27 Cal. App. 3d 38 (1972) (the state taxing agency had two methods of enforcement, but only one was specifically subject to exemptions. When the agency employed the second method of enforcement, the exemptions were inapplicable).

⁶⁹Use of this fiction provides "impairment of an exemption" when there would be no exemption unless the property becomes subject to process or is converted into proceeds. *In re Herman*, 120 B.R. 127, 131-32 (9th Cir. BAP 1990).

⁷⁰*Schneider*, 9 B.R. at 490; *In re Sanford*, 8 B.R. 761, 765 (N.D. Cal. 1981); *Donaldson*, 156 B.R. at 54.

⁷¹*Cf. Reed*, 940 F.2d at 1322-23 & n.7.

⁷²*Hyman*, 967 F.2d at 1321.

⁷³The fiction may be employed in actions to avoid creditor's liens because if the creditor were able to exercise his rights to reduce the residence to proceeds, he would do so by execution sale and those proceeds would be exempt. But applied to a bankruptcy sale, the fiction is improper because if the bankruptcy trustee reduced the property to proceeds pursuant to his rights under Bankruptcy Code § 363, the proceeds would not be exempt.

IV. PUBLIC POLICY SUPPORTS LIMITING THE EXEMPTION TO THE PROCEEDS OF EXECUTION SALES

A. THE RULE OF LIBERAL CONSTRUCTION DOES NOT APPLY TO EXPAND THE SCOPE OF SECTION 704.720

The *Pladson* court was criticized for not employing the rule of liberal interpretation of exemption statutes.⁷⁴ The rule, however, cannot override statutory language and legislative history.⁷⁵ Moreover, the rule does not apply to an exemption statute which limits an exemption to a specific type of property, e.g., proceeds of execution sales.⁷⁶ Nor can the rule remove conditions (e.g., conversion of equity into execution sale proceeds) attached to an exemption.⁷⁷

B. LIMITING THE HOMESTEAD EXEMPTION DOES NOT INTERFERE WITH FEDERAL POLICY OR THE CALIFORNIA CONSTITUTION

When Congress enacted section 522(b)(1), granting the states the freedom to opt out of the federal exemption scheme in deference to their own exemption schemes, Congress did not require that the state exemption scheme be comparable to the federal scheme and allowed states to provide for no homestead exemption if they so chose.⁷⁸ Bankruptcy Code § 522(b)(1) itself allows a debtor a homestead exemption of only \$7,500, and offers no support for a higher exemption. California mirrored this \$7,500 homestead exemption in section 703.140(b)(1).

Although the California Constitution⁷⁹ requires that the Legislature protect a certain portion of a debtor's residence from forced sale, the requirement is not self-executing, and

⁷⁴*Donaldson*, 156 B.R. at 53.

⁷⁵*Anderson*, 824 F.2d at 759 ("[L]iberal construction in favor of the debtor does not give us license to rewrite the California Legislature's scheme for homestead protection. We are compelled by the statutory language and legislative history to conclude these debtors are not entitled to exemption . . .").

⁷⁶*Pierson*, 2 Cal. 2d at 65.

⁷⁷*Golden*, 789 F.2d 698. In *Golden*, the Ninth Circuit held that requiring a debtor to use the proceeds of a voluntary prepetition sale of a homestead to purchase another homestead within six months of the sale was a condition of exemption which survived bankruptcy.

[Removing the condition] would frustrate the objective of the California homestead exemption and the bankruptcy act itself, which limits exemptions to that provided by state or federal law. *Id.* at 700.

⁷⁸*Owen*, 111 S. Ct. at 1835; *Pitrat*, 947 F.2d at 429; *Golden*, 789 F.2d at 700.

⁷⁹CALIF. CONST. art. 20, § 1.5 provides:

The Legislature shall protect, by law, from forced sale a certain portion of the homestead and other property of all heads of families.

by itself does not exempt any property.⁸⁰ The Legislature has full autonomy and discretion to establish the amount and scope of the homestead exemption. Because it has no duty to protect a debtor's residence from a bankruptcy sale the Legislature did more than it was required when, pursuant to section 703.140(b)(1), it provided bankruptcy debtors with a homestead exemption in the equity of their homes.

**C. THE FUNDAMENTAL BALANCE BETWEEN CREDITORS' RIGHTS
AND THE DEBTOR'S FRESH START
SUPPORTS A LIMITED HOMESTEAD EXEMPTION**

Cases critical of *Pladson* have asserted that failing to apply section 704.720 to bankruptcy sales is akin to forcing a bankruptcy debtor to forfeit the homestead exemption when filing for bankruptcy protection.⁸¹ In fact, *Pladson* affects a debtor's rights only minimally. As with judgment debtors, a bankruptcy debtor's homestead may be sold if the equity exceeds a certain amount. *Pladson* simply changes the amount.

Outside of bankruptcy, the section 704.720 homestead exemption operates to delay a judgment creditor from reaching the judgment debtor's residence until the debtor's equity reaches a level deemed sufficient to ensure that the debtor can relocate.⁸² Creditors are allowed to sell the judgment debtor's residence after the equity surpasses the exemption level.⁸³ The purpose of section 704.720, in other words, is not to deny a creditor's ability to sell a homestead to collect upon its debt, but only to delay that ability. Ultimately, the appreciation in the judgment debtor's residence benefits the creditor who can simply wait until the residence has sufficient equity before forcing the sale. The judgment debtor can use his exemption to retain a portion of the sale proceeds. A balance of the rights of both is achieved.

A bankruptcy filing upsets this balance. Shortly after the filing of bankruptcy, the debt owing to the judgment creditor is discharged, thus eliminating the creditor's prospects of future collection through attachment and appreciation. The intended delay of the enforcement of a creditor's rights becomes an unintended denial of those rights, contrary to the intent of section 704.720.

Thus, the Legislature now allows the sale of a homestead once its equity exceeds \$7,500, the amount set forth in section 703.140(b). The Legislature had sound reason to limit the section 704.720 homestead exemption to execution sales: to maintain the balance between debtors' rights and creditors' rights. The Legislature purposely may have placed the proceeds of bankruptcy sales outside the scope of section 704.720 as a *quid pro quo* for

⁸⁰*Pfeiffer v. Riehn*, 13 Cal. 643 (1859) (interpreting a previous version of CALIF. CONST. art. 20, § 1.5); *San Diego County Carpenters Group Ins. v. Lorea*, 112 Cal. App. 3d 221 (1980).

⁸¹*Norman*, 157 B.R. at 465; *Donaldson*, 156 B.R. at 54.

⁸²*Thorsby v. Babcock*, 36 Cal. 2d 202, 205 (1950).

⁸³The exemption level is set forth in CAL. CODE CIV. PROC. § 704.730.

the discharge of debt.⁸⁴ A bankruptcy debtor who will have all debts discharged probably does not need as great an exemption as a judgment debtor who remains liable for his debts.⁸⁵ Certainly, the homestead limitation is neither draconian⁸⁶ nor unprecedented.⁸⁷

V. SPENCER REMAINS GOOD LAW

A. POST-SPENCER NINTH CIRCUIT DECISIONS DO NOT CHANGE THE RESULT THAT SECTION 704.720 APPLIES ONLY TO PROCEEDS OF EXECUTION SALES

Two Ninth Circuit cases decided after *Spencer*, *In re Hyman*⁸⁸ and *In re Chabot*,⁸⁹ have tangentially discussed the scope of section 704.720.⁹⁰ However, they did not consider *Spencer* and did not overrule, distinguish, or alter its holding.

In *Hyman*, the court stated that a trustee could not sell property pursuant to section 704.800⁹¹ unless there were sufficient sale proceeds to satisfy all encumbrances plus the

⁸⁴When the policy behind legislation is not expressly stated, the court interpreting that legislation may properly attribute reasonable policy considerations to the legislature. See *Talmadge*, 832 F.2d at 1125.

⁸⁵*Weiman v. Stopher (In re Weiman)*, 22 B.R. 49, 56 (9th Cir. Bankr. 1982) (Kate, J. dissenting) ("In exchange for having their debts discharged, the unsecured creditors are given certain rights . . . which have the effect of bringing into the estate all property which could have been available to them on the day bankruptcy was filed. The debtor, on the other hand, is given a discharge of his debts and receives a fresh start")

⁸⁶In the 50 states and three federal territories, there are 28 jurisdictions in which the exemption an individual may apply to his homestead does not exceed \$10,000. Moreover, the largest single exemption which an individual can claim for a homestead in 10 of those jurisdictions is \$7,500, while the largest single exemption which an individual can use for a homestead in 13 of those jurisdictions is less than \$7,500. See generally COLLIER BANKRUPTCY EXEMPTION GUIDE (Mathew Bender 1991).

⁸⁷The declared homestead also does not apply to bankruptcy sales because the declared homestead exempts proceeds from voluntary sales, and voluntary sales do not occur within the context of a bankruptcy. *In re Cole*, 93 B.R. 707, 709 (9th Cir. BAP 1988); cf. *United States v. Technical Knockout Graphics, Inc. (In re Technical Knockout Graphics, Inc.)*, 833 F.2d 797, 802 (9th Cir. 1987) (chapter 11 debtor's payments are involuntary because estate property cannot be distributed without Bankruptcy Code or court authority).

⁸⁸967 F.2d 1316 (9th Cir. 1992).

⁸⁹992 F.2d 891 (9th Cir. 1993).

⁹⁰As discussed in Section III.B., *supra*, *Spencer* binds the federal courts. Pre-*Spencer* federal decisions allowing debtors to claim a § 704.720 exemption against a bankruptcy trustee sale were superseded by *Spencer's* interpretation of California law.

⁹¹CAL. CODE CIV. PROC. § 704.800 governs the circumstances under which a forced sale of a homestead may be permitted. The *Hyman* court did not discuss whether forcing a bankruptcy trustee to comply with the provisions of § 704.800 might violate the Supremacy Clause of the United States Constitution to the extent that the state law sale procedures conflict with the sale procedures set forth in the Bankruptcy Code and the Federal Rules of Bankruptcy Procedures.

debtor's allowed homestead exemption.⁹² In its calculations, the court used the section 704.720 exemption because it already had been allowed.⁹³ The *Hyman* court did not have before it an objection to the homestead exemption and thus the case does not support a holding that the section 704.720 exemption was proper.

Chabot likewise fails to offer any guidance on the application of section 704.720 to bankruptcy sales. The case did not involve either section 704.720 or a bankruptcy sale, but the debtor's motion to avoid judgment liens under Bankruptcy Code § 522(f) and sections 704.910-995.⁹⁴ Thus, *Chabot* is neither controlling nor persuasive.

B. POST-PLADSON CASES WHICH REJECT ITS ANALYSIS ARE NOT WELL-FOUNDED

Two recent cases, *In re Donaldson*,⁹⁵ and *In re Norman*,⁹⁶ call *Pladson* bad policy. Exercising judicial activism, both decisions struggle to find legal justifications to apply the section 704.720 homestead exemptions to proceeds of bankruptcy sales. Both cases rely on faulty principles.

In *Donaldson*, a bankruptcy court allowed a debtor to exempt a residence from a sale by a bankruptcy trustee. The court specified five reasons⁹⁷ for its holding that the proceeds of a sale of a residence by a bankruptcy trustee are included in the scope of section 704.720, each of which has been explored and refuted elsewhere in this article.

In *Norman*, the court cited seven reasons⁹⁸ for allowing the debtor to protect his

⁹²The determination of the applicable exemption in proceeds becomes important in CAL. CODE CIV. PROC. § 704.800 and, thus, in CAL. CODE CIV. PROC. § 704.720(a), because before a forced sale can take place, the court must determine whether the sale will satisfy the claimed exemption.

⁹³See *Taylor v. Freeland & Kronz*, 112 S. Ct. 1644 (1992) (exemptions which might not otherwise be allowed may be claimed and used by bankruptcy debtors in the absence of timely objection).

⁹⁴*Chabot* contains some language seeming to support the use of the declared homestead exemption in bankruptcy sales, but as the issue before it was strictly a § 522(f) issue, its language is only *dicta*. 992 F.2d at 895.

⁹⁵156 B.R. 53.

⁹⁶157 B.R. 460.

⁹⁷First, the *Donaldson* court held that *Spencer* did not apply because of the difficulty of applying state homestead law in a bankruptcy context. Second, the court inferred a legislative intent to expand the homestead legislation to bankruptcy sales. Third, the court relied on legislative inaction, stating that the legislature never acted to amend the statutes after previous cases allowed § 704.720 to apply to bankruptcy sales. Fourth, relying on two cases involving the previous, significantly different version of the homestead exemption, the court found that the proceeds of all forced sales fall within § 704.720. Finally, relying on a case involving a debtor's right to avoid judicial liens under Bankruptcy Code § 522(f), the court employed legal fictions to find that bankruptcy sales are the equivalent of execution sales.

⁹⁸First, the *Norman* court posited a Congressional intent to ensure a homestead exemption and a legislative intent to apply the § 704.720 homestead exemption to bankruptcy sales. Second, it deemed the bankruptcy trustee as the equivalent of a judgment creditor seeking to liquidate a money judgment. Third, it failed to differentiate between applying § 704.720 to "bankruptcy cases" and applying it to "bankruptcy sales," and found that § 703.140(a) is superfluous unless it expands §

(continued . . .)

homestead from a bankruptcy sale. Each of these arguments is unsound and has been discussed elsewhere herein. The court made a novel argument in support of its position that a bankruptcy sale is the equivalent of an execution sale, but upon close scrutiny the argument crumbles.⁹⁹

VI. SENATE BILL 651 DOES NOT REQUIRE THAT BANKRUPTCY DEBTORS RECEIVE A SECTION 704.720 HOMESTEAD EXEMPTION IN THE PROCEEDS OF A BANKRUPTCY SALE

In September 1993, the Legislature passed Senate Bill 651 ("Bill") changing the language of section 703.140(a), and the Bill was signed into law by Governor Wilson on October 10, 1993.¹⁰⁰ This change will not affect the holding of *Pladson* or expand the scope of the section 704.720 homestead exemption when it is applied in bankruptcy cases.

⁹⁹(. . . continued)

704.720 to bankruptcy sales. Fourth, it applied § 704.800 without defining the amount of exemption, if any, which must be paid a debtor to allow a bankruptcy sale to proceed. Fifth, it held that *Spencer* did not apply because it did not involve bankruptcy. Sixth, it believed that *Pladson* precludes the application of any exemptions to bankruptcy sales. Finally, it attributed the bankruptcy trustee's power of sale to his standing as a judgment creditor.

⁹⁹The *Norman* court states that precedence can be found in CAL. CODE CIV. PROC. §§ 688.020 and 688.030 for treating nonexecution tax sales like execution sales. 157 B.R. at 466. In fact, a comparison of tax sales and bankruptcy sales supports *Pladson's* holding. CAL. CODE CIV. PROC. § 688.020(a) authorizes the state to recover delinquent taxes by conducting a sale of property under CAL. CODE CIV. PROC. §§ 695.010-709.030 ("Division 2"). If the state elects the remedy of conducting a sale under Division 2, then CAL. CODE CIV. PROC. § 688.030(a)(1) allows the taxpayer to claim exemptions, including the § 704.720 homestead exemption. However, if the state chooses remedies other than those under Division 2, the sale is a different type of sale and exemptions are not allowed. *Greene v. Franchise Tax Bd.*, 27 Cal. App. 3d 38 (1972). Similarly, if a bankruptcy trustee were to sell the debtor's property pursuant to Division 2 by using his powers under 11 U.S.C. § 544, the § 704.720 homestead exemption might be available to the debtor. The law is clear, however, that a trustee does not sell as a judgment creditor under 11 U.S.C. § 544, but as a bankruptcy trustee under 11 U.S.C. § 363. See Section III.C., *supra*. Therefore, as in *Greene*, the § 704.720 homestead would not apply.

¹⁰⁰The Bill provides in part:

SECTION 1. Section 703.140 of the Code of Civil Procedure is amended to read:

703.140. (a) ~~If a petition is filed~~ In a case under Title 11 of the United States Code, all of the exemptions provided by this chapter including the homestead exemption, other than the provisions of subdivision (b) ~~of this section shall be~~ are applicable regardless of whether there is a money judgment against the debtor or whether a money judgment is being enforced by execution sale or any other procedure. . .

SEC. 2.[sic] The Legislature finds and declares that the amendment of § 703.140 of the Code of Civil Procedure by Section 1 of this act pertaining to exemptions in bankruptcy is not a change in, but is declaratory of, existing law. The Legislature further finds and declares that the decision in *In re Pladson*, 154 B.R. 305 (N.D. Cal. 1993), holding that the homestead exemption is not available in bankruptcy, is not a correct interpretation of California law. The Enforcement of Judgments Law provides exemptions for various forms of property. It is not, and never has been, the intention of the Legislature to restrict any of the exemptions in bankruptcy because of technical language concerning the procedures for claiming exemptions in state money judgment enforcement proceedings under the Enforcement of Judgments Law. . . .

**A. THE BILL DOES NOT EXPAND THE SECTION 704.720
HOMESTEAD EXEMPTION TO INCLUDE
BANKRUPTCY SALE PROCEEDS**

**1. Section 703.140, As Amended, Is Declaratory of Existing Law
And Does Not Expand the Scope of the Homestead Exemption**

The rules of statutory construction discussed in section IIB, *supra*, apply to the Bill. The plain language of the statute controls unless it is directly contrary to all legislative history.

Section 1 of the Bill amends section 703.140(a) to state explicitly that all of the California nonbankruptcy exemptions apply to bankruptcy cases regardless of whether there is a money judgment or whether a money judgment is being enforced.¹⁰¹ The plain language of amended section 703.140 allows bankruptcy debtors to claim exemptions regardless of whether there is a money judgment against them.

The amended statute retains the use of the term "applicable," which does not connote an expansion of the exemptions. It continues to apply the California exemptions in bankruptcy without broadening their scope.

The section 704.720 homestead exemption (unchanged by the new legislation) still applies only to execution sales and their proceeds.¹⁰² As stated above, the amendment to section 703.140 removes any confusion regarding the need for a money judgment to be enforced before the automatic homestead exemption is available in bankruptcy.¹⁰³ That is not the same, however, as stating that the automatic homestead exemption is applicable to proceeds of bankruptcy sales. So long as the property being exempted by section 704.720 is limited to execution sale proceeds, the exemption may only be employed in that context.

**2. The Legislative History of The Bill Does Not
Contradict The Statute's Plain Meaning**

The legislative history of amended section 703.140, set forth in section 2 of the Bill, is not directly contrary to the plain language of the statute. The Legislature says both that the amendments reflect a declaration of existing law (that the exemptions apply in bankruptcy) and that *Pladson* was incorrect when it held that the exemptions do not apply in bankruptcy.

¹⁰¹Although previous § 703.140 applied the exemption statutes in bankruptcy cases, the court in *Norman*, 157 B.R. at 465, held that a strict construction of the exemption statutes could prevent bankruptcy debtors from applying any exemption in bankruptcy unless the debtors were judgment debtors.

¹⁰²See section III, *supra*.

¹⁰³See note 97, *supra*.

The Legislature's statement that the amendments are a declaration of existing law is consistent with the plain meaning of amended section 703.140. The amended language reaffirms that the California nonbankruptcy exemptions apply in bankruptcy cases even to debtors regardless of whether they have a money judgment against them, and to property regardless of whether it is subject to sale.¹⁰⁴ Consequently, notwithstanding additional legislative history, the plain meaning of amended section 703.104 should be applied.¹⁰⁵

The Legislature's statement that *Pladson* was incorrect does not render the legislative history contrary to the amended statute's plain meaning, because the Legislature incorrectly summarized *Pladson's* holding. The Legislature viewed as incorrect *Pladson's* "holding" that the homestead exemption is not available in bankruptcy cases. *Pladson* actually stated that the homestead exemption is available in bankruptcy,¹⁰⁶ but held that the homestead exemption's scope is limited and does not apply to bankruptcy sale proceeds.¹⁰⁷ *Pladson* dealt with the applicability of the section 704.720 homestead exemption to bankruptcy sales, while section 703.140 deals with the applicability of the section 704.720 exemption to bankruptcy cases. The legislative history of amended section 703.140 confuses the two issues when it refers to *Pladson's* holding. The remaining language of the legislative history, however, indicates the Legislature's true concern was with applying the exemption in bankruptcy cases. The plain meaning of the amended language answers that concern by making it clear that the exemption does apply.

It would be incorrect to construe amended section 703.140 to broaden the scope of section 704.720 to bankruptcy sale proceeds because it would be contrary to the statement that the amended section is declaratory of existing law. Section 703.140 as first enacted was never intended to expand the scope of the California exemptions.¹⁰⁸ Hence, using section 703.140 to expand the scope of section 704.720 would not be declaratory of existing law.

The Bill's legislative history does not override the plain meaning of its language. At best, the history supports the plain meaning. At worst, the history is confusing. At no point is it directly contradictory.

¹⁰⁴See section II.B.3, *supra*.

¹⁰⁵*Belleci*, 24 Cal. 3d. at 884-86; *Boyd*, 24 Cal. 3d at 294.97.

¹⁰⁶*Pladson*, 154 B.R. at 307 (bankruptcy debtors are entitled to a § 704.720 exemption when an execution sale is enforced).

¹⁰⁷154 B.R. at 306.

¹⁰⁸See section II.B.1., *supra*.

**B. EVEN IF THE NEW BILL IS DEEMED TO CHANGE THE LAW,
IT WOULD NOT OVERRULE PLADSON
OR CHANGE ITS RESULT RETROACTIVELY**

Pladson is currently on appeal to the Ninth Circuit. If the Ninth Circuit were to find that the Bill, rather than being declaratory of existing law, substantively changes the law to provide all bankruptcy debtors with an exemption under section 704.720 for all bankruptcy sales, the amended law would not apply retroactively to *Pladson* or to any other cases pending before the Bill was enacted.

When a court has interpreted a statute, the Legislature cannot overrule that decision by enacting changes to the statute and stating that the changes are declaratory of existing law. Doing so would be an unconstitutional interference with the judicial function¹⁰⁹ and would violate the separation of powers clause of the California Constitution.¹¹⁰

Although a legislature may state that legislative amendments are declaratory of existing law, the statement is suspect at best¹¹¹ and courts are not bound to accept it.¹¹² If

¹⁰⁹*People v. Savala*, 116 Cal. App. 3d 41, 60 (1981). In *Savala*, the California Supreme Court had interpreted a criminal statute. The Legislature then passed a "clarification" statute which stated that the criminal statute always had had a meaning inconsistent with the Supreme Court decision. The *Savala* court had to decide whether to construe the criminal statute in conformity with the prior Supreme Court interpretation or the legislation. On the grounds of *stare decisis*, the *Savala* court held that it was bound to follow the Supreme Court. The *Savala* court also held that the Legislature's attempt to interpret a statute after it has been passed upon by the judiciary could be a violation of the separation of powers clause of the California Constitution.

¹¹⁰*Romein v. General Motors Corporation*, 436 Mich. 515, 539 n.20, 546, 561 (1990), *aff'd* 112 S. Ct. 1105 (1992) (The court held that the Michigan Constitution's separation of powers clause, which was virtually identical to California's, prohibited the legislature from overruling cases but not from changing the law prospectively). CALIF. CONST. art. III, § 3, reads as follows:

The powers of state government are legislative, executive, and judicial. Persons charged with the exercise of one power may not exercise either of the others except as permitted by this Constitution.

¹¹¹*See Mackey v. Lanier Collection Agency & Service*, 108 S. Ct. 2182, 2191 (1988) ("The views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one"); *Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 100 S. Ct. 2051, 2061 n.13 (1980) ("Even when it would otherwise be useful, subsequent legislative history will rarely override a reasonable interpretation of a statute that can be gleaned from its language and legislative history prior to its enactment"); *United Air Lines, Inc. v. McMann*, 98 S. Ct. 444, 449 n.7 (1977) ("Legislative observations 10 years after passage of the Act are in no sense part of the legislative history").

¹¹²*California Emp. Etc. Com. v. Payne*, 31 Cal. 2d 210, 213-44 (1947); *Lawrence v. City of Concord*, 156 Cal. App. 2d 531, 534 (1958).

In *Payne*, the relevant statute of limitations was limited just prior to the plaintiff's filing of an action. The court rejected as absurd the position that the addition of a limitation which was plainly absent from the statute as originally drafted was a mere clarification of the statute.

Likewise, in *Lawrence*, a plaintiff claimed that he was statutorily entitled to reimbursement for construction of a storm drain. The plaintiff relied on an amendment to the relevant statute specifically including reimbursements for storm drain construction and a statement that the amendment constituted a clarification of existing law. The court disregarded the legislative statement that the amendment was a declaration of existing law and ruled against plaintiff on the grounds that the original statute's language never applied to storm drains.

But cf. Union League Club v. Johnson, 18 Cal. 2d 275 (1941). There the court found that a change in a statute's wording did not necessarily preclude it from being considered a clarification where the language in the original statute supported such a finding.

the amendment to a statute is termed a declaration or clarification of existing law, but actually effectuates a change in the law, the amendment is not retroactive.¹¹³

Even if the ordinary presumption were that legislation mistakenly deemed declaratory by the Legislature should be deemed retroactive, the Bill could not apply retroactively. Bankruptcy Code § 522 only allows debtors to use exemptions in force at the time of their bankruptcy filing. Giving a change in the state exemption law retroactive effect in bankruptcy would violate the Supremacy Clause of the United States Constitution.¹¹⁴

VII. CONCLUSION

The holding of *Spencer* was clear and cannot be ignored: section 704.720, the California automatic homestead exemption, applies only to the proceeds of execution sales. *Pladson* properly followed the state court's holding when interpreting the exemption in a bankruptcy case. Because bankruptcy sales are not execution sales, the section 704.720 has limited applicability in bankruptcy cases. Debtors may still, however, claim an exemption of \$7,500 under section 703.140(b). This plain meaning construction of sections 703.140 and 704.720 provides a result consistent with the other exemption statutes, the Bankruptcy Code, and public policy, and is unchanged by Senate Bill 651.

¹¹³*Payne*, 31 Cal. 2d at 214.

¹¹⁴*In re Peacock*, 119 B.R. 605, 609-610 (Bankr. N.D. Ill. 1990); *In re McKeag*, 104 B.R. 160, 163-65 (Bankr. D. Minn. 1989); see also *Watson v. Kincaid* (*In re Kincaid*), 96 B.R. 1014, 1021 (9th Cir. BAP 1989), *rev'd on other grounds*, 917 F.2d 1162 (1990).