

COMMENT

SAYING GOODBYE TO TEXAS’S HOMESTEAD PROTECTION: ONE STEP TOWARD ECONOMIC EFFICIENCY WITH THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005

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I. INTRODUCTION

In 2005, the U.S. Congress passed the most significant overhaul of the Bankruptcy Code in over a quarter-century.¹ This overhaul, long called for by creditors and resisted by many consumer groups, pits two ideologies against each other.² On the one side is the credit industry, which for eleven years now has been making a concerted effort to elect sympathetic lawmakers.³ These creditors seek to maximize recovery of the money they lend.⁴ The credit industry, noting the nearly 1.6 million personal bankruptcies in 2003 alone (up from 1.3 million in 1999),⁵ has demanded a new look at the ease of declaration of bankruptcy and the property exemption it entitles.⁶ This ease of declaration

1. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11 U.S.C.); see also Michelle Arnopol Cecil, *Bankruptcy Reform: What's Tax Got to Do with It?*, 71 MO. L. REV. 879, 879 (2006) (characterizing the legislation as “the most sweeping bankruptcy reform legislation . . . in over a quarter of a century”).

2. See Vern McKinley & Joseph Pomykala, *Bankruptcy Reform: Dead for This Year but Still Badly Needed*, CATO INSTITUTE, Oct. 30, 1998, <http://www.cato.org/dailys/10-30-98.html> (noting the debate between reform advocates (credit card companies) and reform opponents (bankruptcy attorneys and consumer advocates)); see also Charles G. Hallinan, *The “Fresh Start” Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretive Theory*, 21 U. RICH. L. REV. 49, 50 (1986) (discussing the dual roles of bankruptcy as protection for creditors and a mode for “fresh start” for debtors).

3. See Elizabeth Warren, *Show Me the Money*, N.Y. TIMES, Oct. 24, 2005, at A21 (observing that creditors had begun the push to re-elect sympathetic members of Congress eleven years before the Act went into effect).

4. Cf. Lawrence Ponoroff & F. Stephen Knippenberg, *The Immovable Object Versus the Irresistible Force: Rethinking the Relationship Between Secured Credit and Bankruptcy Policy*, 95 MICH. L. REV. 2234, 2249 n.53 (1997) (noting that while some view the bankruptcy laws as a means to “maximize creditor returns,” even those who take this view do not “question the centrality of fresh-start policy”).

5. U.S. GEN. ACCOUNTING OFFICE, GAO-04-465R, MILITARY PERSONNEL: BANKRUPTCY FILINGS AMONG ACTIVE DUTY SERVICE MEMBERS 2 (2004), available at <http://www.gao.gov/new.items/d04465r.pdf>; News Release, Administrative Office of the U.S. Courts, Personal Bankruptcy Filings Continue to Rise in Fiscal Year 2003 (Nov. 14, 2003), available at <http://www.txnb.uscourts.gov/release/FY03BK.pdf> (listing bankruptcy filings for the years 1999 through 2003); see also 146 CONG. REC. S11629 (daily ed. Dec. 6, 2000) (statement of Sen. Torricelli) (noting the stark rise in filings).

6. See, e.g., Gene Tharpe, *Consumer Watch Coalition Poised to Pounce if Bankruptcies Are Eased*, ATLANTA J. & CONST., July 20, 1997, at D8 (reporting that “a

moderates the filer's incentive to look for alternatives such as refinancing, debt consolidation, or changes in lifestyle.⁷ The filer need only pay a nominal fee to a lawyer, make a brief court appearance, and endure the stigma of bankruptcy; in exchange, nearly every outstanding debt is erased. In addition, the filer retains certain assets, which may include an unlimited homestead exemption in some states.⁸

On the other side of this debate are consumer advocates who tout the debtor's goal of making a "fresh start."⁹ The intent of a declaration of bankruptcy is to provide "an opportunity . . . for financial rebirth."¹⁰ Bankruptcy laws in the United States foster this by (1) sheltering debtors from the fear and reality of inescapable debt;¹¹ (2) ending the ongoing efforts of collection agents;¹² and (3) sheltering certain property to give the debtor something of a nest egg from which to rebuild his financial life—a phoenix from the ashes.¹³

Although, admittedly, there has been an increase in the number of personal bankruptcies, consumer advocates like Senator Ted Kennedy make the emphatic argument that the credit card industry's increasing profits are a clear indication that the industry is no worse off for the protections offered by the bankruptcy laws.¹⁴ In addition, consumer advocates often debunk

coalition of banks, credit unions, credit card issuers and retail stores" were "calling for greater restrictions on filing for personal bankruptcy").

7. Cf. Lesley Mitchell, *Consumers: New Requirement for Counseling May Put Debtors at Risk; Counseling Requirement Worries Some; Bankruptcy's Next Chapter*, SALT LAKE TRIB., Oct. 9, 2005, at E1 (discussing the new Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) rules mandating pre-declaration credit counseling aimed at educating would-be filers about alternatives to filing bankruptcy).

8. See *infra* note 196 and accompanying text.

9. William T. Vukowich, *Debtors' Exemption Rights Under the Bankruptcy Reform Act*, 58 N.C. L. REV. 769, 801 (1980); see also Hallinan, *supra* note 2, at 50 (identifying the provision of a "fresh start" to overburdened debtors as one of the key functions of the bankruptcy system).

10. Adam J. Hirsch, *Inheritance and Bankruptcy: The Meaning of the "Fresh Start,"* 45 HASTINGS L.J. 175, 175 (1994).

11. But see Katherine Porter & Deborah Thorne, *The Failure of Bankruptcy's Fresh Start*, 92 CORNELL L. REV. 67, 69 (2006) (reporting that up to one-third of post-filing debtors feel "that their financial situations were actually the same as or worse than at the time of their bankruptcies").

12. 11 U.S.C. § 362 (2000); see also Oksana Lashko, Note, *Enhancing Creditor Recovery: Should Services Be Deemed "Property" for the Purposes of Fraudulent Transfer Law?*, 72 BROOK. L. REV. 317, 323 (explaining that bankruptcy "creates an 'automatic stay' that stops all individual creditor collection efforts").

13. See Hirsch, *supra* note 10, at 175–76 (stating that bankruptcy wipes out unpaid debt, exempts certain property from creditors' reach, and restores the debtor's solvency).

14. See David Swanson, *Debt Slavery: What the Bankruptcy Bill Could Do To You*, BLACK COMMENTATOR, Mar. 31, 2005, http://www.blackcommentator.com/132/132_guest_bankruptcy_bill_pf.html (quoting Andy Serwer, *Congress to Business: How*

the contention that it is the “fat cat” who is cheating the system.¹⁵ Instead, they point to the fact that the average filer is not far above the poverty line, with an income of less than thirty thousand dollars.¹⁶ These advocates successfully fought off bankruptcy reform during the Clinton Administration.¹⁷ More recently, they lobbied unsuccessfully to curtail the impact of the current reforms on those in the military and victims of natural disasters.¹⁸ In the end, however, the reforms were passed and subsequently signed into law by President George W. Bush on April 20, 2005.¹⁹

From a law and economics perspective, these reforms are welcome.²⁰ But the question remains, do the reforms go far enough? This Comment poses two questions. The first question is whether homestead protection in Texas has struck a correct balance between the public policy goals of efficient allocation of credit in society and protection of debtors.²¹ The second is whether the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) has moved the law in a more efficient direction. This Comment contends that the answer to the first is “no,” and the second is an attenuated “yes.”

May I Serve You?, FORTUNE, Apr. 4, 2005, at 47) (noting that the credit card industry saw profits rise from \$12.9 billion in 1995 to \$31.6 billion in 2004); cf. Bryan Bender, *Democrats Push for Protections in Bankruptcy Bill*, BOSTON GLOBE, Mar. 1, 2005, at A2 (quoting Ted Kennedy’s characterization of the bankruptcy reform legislation as one “written by the credit card companies for the credit card companies and of the credit card companies”).

15. See generally A. Mechele Dickerson, *Race Matters in Bankruptcy Reform*, 71 MO. L. REV. 919, 938–39 (2006) (discussing the “deadbeat” and cheater stigma that may accompany bankruptcy for some consumers).

16. See U.S. Census Bureau, *Poverty Thresholds 2005*, <http://www.census.gov/hhes/www/poverty/threshld/thresh05.html> (last visited Apr. 14, 2007) (showing that the poverty line for a family of four in 2005 was \$20,144); see also Melissa B. Jacoby, Teresa A. Sullivan, & Elizabeth Warren, *Rethinking the Debates over Health Care Financing: Evidence from the Bankruptcy Courts*, 76 N.Y.U. L. REV. 375, 376 n.2 (2001) (reporting an average filer’s salary of \$28,000, with 1.4 times his salary in debt).

17. See Kathleen Day, *Tighter Bankruptcy Law Favored; Bills Making It Harder to Erase Debt Set to Clear Congress*, WASH. POST, Feb. 11, 2005, at A5 (observing that President Clinton once refused to sign bankruptcy reform legislation because “it was unfair to consumers”).

18. See Warren, *supra* note 3.

19. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11 U.S.C.).

20. See Todd J. Zywicki, *Institutions, Incentives, and Consumer Bankruptcy Reform*, 62 WASH. & LEE L. REV. 1071, 1072 (2005) (observing that the seven-fold increase in bankruptcies over the last twenty-five years may be explained “as a direct and predictable response to the incentives provided by the bankruptcy law”).

21. See Alvin K. Klevorick, *Law and Economic Theory: An Economist’s View*, 65 AM. ECON. REV. 237, 241 (1975) (conceding that an economist’s perception is not always the preferred path, and questions should also “be resolved by appeals to history, to political theories of democracy, and to sociological theories of the role expectations of different members of the society”).

Part II of this Comment reviews the history of both the federal bankruptcy provisions and the Texas state provisions. Texas holds the unique claim of being the first state to have bankruptcy protection statutes protecting the homestead.²² Nonetheless, the federal government promulgated its own bankruptcy code, and provided for national homestead protection for the first time in the Bankruptcy Act of 1867.²³ Today all fifty states have bankruptcy codes of their own.²⁴ This section reviews the history of the federal code and the Texas code up to the eve of the 2005 reforms.

Part III of this Comment is a law and economics assessment of bankruptcy provisions for a homestead exemption. Law and economics proponents argue that state regulation in most areas of the economy leads to inefficiencies and distortions.²⁵ Creditors have long called for reductions in regulatory safeguards for those who renege on their contractual obligations.²⁶ At the same time, consumer advocates argue the government needs to provide those who fall behind with a safe way out of their financial difficulties.²⁷ This section reviews the role of bankruptcy regulation, asking if it is necessary to prevent the costly externalities of an unregulated market for credit. Or, by contrast, does this regulation cause even greater inefficiencies and distortions in the market for credit? These questions go to the very heart of the wisdom of constricting the homestead exemption.

Part IV of this Comment looks at the effectiveness of BAPCPA in curtailing the problems of an unlimited homestead exemption in Texas. On April 20, 2005, creditors and proponents of law and economics finally gained a victory in Texas as the

22. Richard M. Hynes et al., *The Political Economy of Property Exemption Laws*, 47 J.L. & ECON. 19, 19 (2004) (reflecting that the Texas homestead exemption was established in part to encourage settlers into the territory).

23. Bankruptcy Act of 1867, ch. 176, 14 Stat. 517 (repealed 1878); see also Baxter Dunaway, *Attachment Is a Key to Understanding Protecting Homesteads by Avoiding Judicial Liens in Bankruptcy Using § 522(f)(1)*, 12 J. BANKR. L. & PRAC. 233, 233–34 (2003) (discussing how homestead protection is achieved through lien avoidance in federal law); *infra* note 47 and accompanying text.

24. See Hynes et al., *supra* note 22, at 19 (“Every state has laws that protect some of the assets of debtors from the satisfaction of claims by creditors.”).

25. See Darren Bush, *Moving to the Left by Moving to the Right: A Law & Economics Defense of Same-Sex Marriage*, 22 WOMEN’S RTS. L. REP. 115, 115 (2001) (discussing the law and economics view of government regulation).

26. See Day, *supra* note 17 (“Lobbyists for the credit card industry say the legislation is needed to close loopholes that make it too easy for people to wipe out their debts when they could repay some of them.”).

27. See Hallinan, *supra* note 2, at 51 (discussing attacks on legislative and judicial efforts to adjust the bankruptcy system’s “fresh start” objectives).

unlimited exemption was preempted by federal law.²⁸ State bankruptcy codes could no longer provide broader exemptions than the federal code.²⁹ The new BAPCPA, however, was flawed from its inception by a loophole that rendered it nearly impotent.³⁰ Thus, it remains to be seen how the compromise reform will affect Texans who seek to shield their homesteads in bankruptcy proceedings. This section reviews the impact of the newly reformed federal code on Texans who move to declare bankruptcy in its aftermath. Part IV also looks at the probable impacts on the credit market and on opportunistic filing for bankruptcy in Texas.

Part V summarizes the arguments in this Comment, concluding that BAPCPA moves in the right direction in accord with law and economics objectives. In doing so it increases the efficiency of the market for credit in Texas and helps reduce the degree of opportunism in filing. Nonetheless, because it retains an option for filing under more generous state limits in Texas, its impact will be much more attenuated than proponents of reform expect.

II. THE HISTORY OF THE HOMESTEAD EXEMPTION

There are two primary benefits in bankruptcy: the discharge of debt owed and the exemptions to liquidation of the estate.³¹ Among the most important exemptions is that of the homestead, usually the single greatest asset in the estate.³² The history of the homestead exemption flows from both the federal and the state law. Both contain provisions for homestead protection when filing under Chapter 7.³³ In addition, the ability of many states'

28. See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 322(a), 119 Stat. 23, 96 (codified as amended at 11 U.S.C. § 522) (imposing limits even when a debtor elects to obtain an exemption under state law).

29. *Id.* (capping any homestead exemption available under state law at the \$125,000 federal exemption limit).

30. See *id.* (applying the federal homestead exemption cap only to properties owned for less than 1215 days, about forty months, preceding the date of filing for bankruptcy).

31. See William Houston Brown, *Political and Ethical Considerations of Exemption Limitations: The "Opt-Out" as Child of the First and Parent of the Second*, 71 AM. BANKR. L.J. 149, 163 (1997); see also 11 U.S.C. § 727 (1994) (discharging, under Chapter 7, all debts not listed as exceptions); 11 U.S.C. § 1328 (1994) (discharging, under Chapter 13, all debts not listed as exceptions); Hallinan, *supra* note 2, at 99 (discussing the benefits of filing for bankruptcy).

32. See Liz Pulliam Weston, *Are You on Track to Retire Rich?*, <http://moneycentral.msn.com/content/SavingandDebt/P61280.asp> (last visited Apr. 14, 2007) (noting that an analysis of the 2001 Federal Reserve's Survey of Consumer Finances shows that home equity accounts for over fifty percent of total net worth of many Americans).

33. See 11 U.S.C. § 522(b)(1)-(d)(1) (1994) (providing for homestead exemption under federal law); TEX. CONST. art. XVI, § 50(a) (Supp. 2006) (providing for homestead

residents to opt for the federal protection is an important element.³⁴

A. *The History of Federal Homestead Protection*

The U.S. Constitution reserves for the federal government the power to make bankruptcy laws.³⁵ Historically, laws governing the creditor-debtor relationship tended to favor creditors to the exclusion of debtors.³⁶ This is evident in the laws of early American states like Pennsylvania, where as late as 1785, a debtor would first be flogged and then could have an ear cut off.³⁷ Likewise, in New York, a debtor could be branded with a “T” for “thief.”³⁸ In each case the costs of insolvency were imposed upon the person taking on the debt and not upon those who might have been unscrupulous lenders.³⁹

At first, Congress addressed the imbalance between the debtor and the creditor through temporary bankruptcy provisions.⁴⁰ It was not until 1898 that Congress enacted a permanent federal bankruptcy code in the Torrey Bill, signed by President William McKinley on July 1, 1898.⁴¹ This legislation shifted the burden of irreconcilable debt by creating an escape route for debtors who found themselves sinking in the quicksand of excessive debt.⁴² According to one commentator, this balance is

exemption in Texas); *see also* Wei Fan & Michelle J. White, *Personal Bankruptcy and the Level of Entrepreneurial Activity*, 46 J.L. & ECON. 543, 544 (2003) (“Chapter 7 requires debtors to give up all of their assets above their state’s exemption level, but their future earnings are completely exempt.”).

34. *See* 11 U.S.C. § 522(b)(1) (1994) (allowing the debtor to choose between federal law and their state’s law with respect to property exemptions); *see also* Hynes et al., *supra* note 22, at 20 (commenting that the legislation was poised for defeat until a compromise allowed states to opt out of the federal plan if they found their own exemptions to be more favorable).

35. U.S. CONST. art. I, § 8, cl. 4; *see also* Fan & White, *supra* note 33, at 544 (commenting that despite the authority of the federal government to create uniform bankruptcy laws, Congress has allowed exemption levels to vary by state).

36. *See* Rhett Frimet, *The Birth of Bankruptcy in the United States*, 96 COM. L.J. 160, 161–62 (1991) (describing the historically harsh treatment of debtors by ancient laws).

37. Joseph Pomykala, *Bankruptcy Reform: Principles and Guidelines*, REGULATION, Fall 1997, at 41 (1997), *available at* <http://www.cato.org/pubs/regulation/reg20n4g.pdf>.

38. *Id.*

39. *See generally* Charles Jordan Tabb, *The Historical Evolution of the Bankruptcy Discharge*, 65 AM. BANKR. L.J. 325, 344–69 (1991) (chronicling the history of Bankruptcy Acts in the United States, including “debtor imprisonment” and “national economic crisis” before federal bankruptcy protection).

40. *See* Frimet, *supra* note 36, at 166–69 (discussing the first temporary bankruptcy provisions, each linked to a specific economic crisis, from 1789 to 1890).

41. CHARLES WARREN, *BANKRUPTCY IN UNITED STATES HISTORY* 140–41 (1935).

42. *See* Frimet, *supra* note 36, at 188 (noting provisions of the Act of 1898 that

more efficient because when debtors become hopelessly insolvent they are likely to embrace a life of leisure and live on state benefits rather than continue to produce in society.⁴³ Allowing debtors to become solvent again renews their desire to reengage and become productive members of the financial community.⁴⁴ The homestead exemption encapsulates the preference for having an individual fend for himself rather than become a ward of the state, which might indeed happen should the creditor strip the debtor of every last asset.⁴⁵

When filing for bankruptcy, a major part of the federal protection against debtors is the homestead exemption.⁴⁶ To provide protection from debt, the homestead is uniquely protected from the attachment of liens under federal law.⁴⁷ This protection was first established in the Bankruptcy Act of 1867, which allowed liens against the homestead to be invalidated.⁴⁸ This legislation acted to balance the desire of creditors to lend to anyone who had assets with the interest in preventing individuals from becoming bereft of all of their worldly possessions.⁴⁹

In 1898, the first “durable” federal bankruptcy law was passed, incorporating the state exemptions.⁵⁰ The revised code governed federal bankruptcy protection for nearly eighty years

allowed debt to be discharged without creditors’ consent or a repayment plan, and concluding that Congress finally “enacted a bankruptcy law that would serve the functions of all concerns as equitably as possible”).

43. See Hirsch, *supra* note 10, at 207.

44. See *id.* at 207–08.

45. See Brown, *supra* note 31, at 163 (recognizing that exemptions are necessary to provide debtors with “access to property that is essential to ‘life and livelihood’”); Michael Denham, Comment, *A Call for Bankruptcy Reform: The Fifth Circuit Limits the Texas Homestead Exemption and Further Complicates the Exemption Controversy*, 30 TEX. TECH. L. REV. 269, 271–72 (1999) (noting the danger of taking every asset from a debtor and that exemptions provide some safeguard against these dangers).

46. See 11 U.S.C. § 522(b) (2006) (providing homestead exemption options to the debtor); see also Randall B. Schmidt, Note, *R.I.P. Chabot? Ninth Circuit Bankruptcy Debtors’ Right to Avoid a Judicial Lien on a Homestead Is Still “Impaired” and the Clarification Doctrine in Doubt After In re Wilson*, 31 U.S.F. L. REV. 1051, 1077 (1997) (concluding that the homestead exemption is among the most important provisions of bankruptcy law).

47. See 11 U.S.C. § 522(f) (2006) (providing the debtor with lien avoidance on exempt homestead property); H.R. REP. NO. 95-595, at 361–62 (1978), as reprinted in 1978 U.S.C.C.A.N. 5963, 6317–18 (elaborating on how the statute protects the debtor’s fresh start).

48. See 4 COLLIER ON BANKRUPTCY ¶ 67.01, at 18 (James Wm. Moore & Lawrence P. King, eds., 14th ed. 1978) (detailing the motivations behind the 1867 legislation).

49. See Tabb *supra* note 39, at 355 (noting that the Bankruptcy Act of 1867 “reflected a compromise between the debtor and creditor interests”).

50. See generally Hynes et al., *supra* note 22, at 23 (discussing the 1898 Act and its implications).

with periodic modifications, until the Bankruptcy Reform Act of 1978 replaced it to bring it into line with modern realities of easy consumer credit.⁵¹ The new code provided for specific lien avoidance on exempt property under § 522(f)(1).⁵² Again, the homestead was paramount on the list of exempt properties, because it was at the center of attempts to reengage the debtor in an active life.⁵³ The 1978 Act is also significant for its compromise.⁵⁴ The House of Representatives wanted federal exemption standards, while the Senate favored state exemption standards.⁵⁵ In the end, the federal standard included a provision that states could “opt-out” in favor of their own standard.⁵⁶

On the eve of BAPCPA, the federal statute governing individual exemptions from bankruptcy was 11 U.S.C. § 522.⁵⁷ Section 522(b) of the code provides that some property can be removed from the estate prior to its liquidation.⁵⁸ One of the goals of bankruptcy law is to ensure that a debtor who goes through bankruptcy comes out with adequate possessions to begin his fresh start.⁵⁹ To that end, the property that may be removed prior to liquidation, under one of the available alternatives in the

51. See H.R. REP. NO. 95-595, at 3 (1978), as reprinted in 1978 U.S.C.C.A.N. 5963, 5965 (commenting on the need for modernization of the bankruptcy laws, which were “designed in 1898, in the horse and buggy era of consumer and commercial credit, and was last overhauled in 1938, nearly 40 years ago”); see also GEORGE M. TREISTER ET AL., FUNDAMENTALS OF BANKRUPTCY LAW 3–5 (2d ed. 1988) (reviewing reasons that reform was necessary, including bringing bankruptcy law in line with modern credit).

52. 11 U.S.C. § 522(f)(1) (1994); see also H.R. REP. NO. 95-595, at 361–62 (1978), as reprinted in 1978 U.S.C.C.A.N. 5963, 6318 (explaining the goals of the subsection).

53. See Phyllis A. Klein, Note, “A Fresh Start With Someone Else’s Property”: Lien Avoidance, the Homestead Exemption and Divorce Property Divisions Under Section 522(f)(1) of the Bankruptcy Code, 59 FORDHAM L. REV. 423, 429–30 (1990) (noting that the “fresh start” principle drives the homestead exemption codified in 11 U.S.C. § 522(f)(1)).

54. See 11 U.S.C. § 522(f)(1) (1994) (providing the statutory basis for the federal property exemptions, while allowing the filer to opt for state law exemptions); see also Hynes et al., *supra* note 22, at 20 (explaining the compromise between the House and Senate).

55. See Hynes et al., *supra* note 22, at 20 (reviewing the differing House and Senate views: the former favored federal exemptions and the latter sought to incorporate state exemptions).

56. 11 U.S.C. § 522(b) (1994); see also *In re Davis*, 105 F.3d 1017, 1023 (5th Cir. 1997) (Duhé, J., dissenting) (“Congress was well aware that state law exemptions would vary. It accepted that variance.”), *rev’d on reh’g en banc*, 170 F.3d 475, 477 (5th Cir. 1999) (concluding that the lower courts correctly denied the levy sought against the Davis homestead); Hynes et al., *supra* note 22, at 24 (summarizing the compromise as a uniform set of rules that the debtor can choose unless his state has formally chosen not to allow the option).

57. See 11 U.S.C. § 522(b) (1994) (describing guidelines for individual exemptions).

58. See *id.* (allowing exemption of property from estate under federal law).

59. H.R. REP. NO. 95-595, at 362 (1978), as reprinted in 1978 U.S.C.C.A.N. 5963, 6318 (highlighting subsection (f) as providing the debtor with the ability to start fresh by allowing avoidance of certain liens).

federal law, includes a homestead (up to \$18,450) and other personal property (up to \$9,850).⁶⁰ But most filers do not have a great deal of valuable personal property at the time of filing, and hence the home is often the center of attempts to recover debt.⁶¹ Since the home is the most prominent asset in many cases, the homestead exemption is an even more important part of providing this fresh start.⁶²

In short, the federal government has been active in protecting the homestead in bankruptcy for nearly 150 years. The protections are not all inclusive, nor are they intended to be, but they are significant to filers because they exempt at least “\$18,450 in value, in real property . . . that the debtor or a dependent of the debtor uses as a residence.”⁶³ In addition to enacting federal protection, “Congress has delegated part of its bankruptcy lawmaking authority to the states because the Code allows states to determine what exemptions a debtor may claim from the bankruptcy estate.”⁶⁴ Hence, even in the face of federal law many filers must look to the state to see what exemptions they can utilize because many states have chosen to “opt-out” of the federal bankruptcy program.⁶⁵ In states where there is a choice, “[m]ost debtors elect to claim homestead exemptions under more generous state laws, making every effort to maximize that exemption.”⁶⁶

Texas has not chosen to “opt-out” of the federal program, but instead offers its citizens the choice of utilizing either the federal or state program.⁶⁷ However, Texans are unlikely to use the federal exemption because it falls far short of state law.⁶⁸ “To put

60. 11 U.S.C. § 522(d) (2006).

61. See Dunaway, *supra* note 23, at 233–34 (noting that in “bankruptcy by a consumer, the debtor’s principal asset is generally the debtor’s home”).

62. See TREISTER ET AL., *supra* note 51, at 299 (discussing lien avoidance as one element that a debtor gets to claim that enables her to get a fresh start).

63. 11 U.S.C. § 522(d)(1) (2006).

64. Denham, *supra* note 45, at 274.

65. See *id.* (indicating that the Texas legislature has not specifically opted out of the federal exemptions, thus allowing debtors to choose between federal and state exemptions).

66. Timothy D. Moratzka, *The “Castle” Under Attack: Homesteads and Bankruptcy*, 20 AM. BANKR. INST. J. 8, 8 (2001). *But see* Brown, *supra* note 31, at 179–80 & n.255 (noting that Tennessee chose to opt out, not to provide a more generous exemption, but instead to limit the homestead exemption to \$5,000 for individual filers).

67. Denham, *supra* note 45, at 274 (noting that the Texas legislature has not opted out); see also TEX. CONST. art. XVI, § 50(a) (Supp. 2006) (providing protection for a Texan’s homestead from most types of debts, barring a few exceptions); TEX. PROP. CODE ANN. §§ 42.001–.002 (Vernon 2000) (enumerating the personal property exemptions).

68. Compare 11 U.S.C. § 522(d)(1) (2006) (providing for a maximum exemption of \$18,450), with TEX. PROP. CODE ANN. § 41.001(a) (Vernon 2000 & Supp. 2006) (placing no

it mildly, the Texas homestead exemption is very beneficial to Texas residents because the Texas Constitution provides that the exemption value is unlimited.”⁶⁹

B. The History of Texas’s Expansive Homestead Protection

The genesis of the homestead exemption is one of the minor mysteries of Texas history. First enacted by the Congress of the Republic of Texas in 1839, the exemption was elevated to constitutional status some six years later. While some similarities to the laws of Spain and the American states from which early Texas settlers came have been noted, the first Texas statute on the subject added an element not found in common or civil law—the protection of every family’s home from creditors.⁷⁰

The evolution of property exemption in Texas was unique in that, prior to its status as a nation unto itself, Texas was a part of Spain and Mexico.⁷¹ Although at English common law there was no concept of exempt property in the face of unpaid debts, there was such a concept in Spanish territories and in The Republic of Mexico.⁷² When the Republic of Texas gained independence, this trend continued.⁷³ Later, when Texas was admitted into the Union, the exemption was grafted into the state constitution.⁷⁴ At that time it was the most liberal exemption in the Union, in part to encourage

limit on the value of the homestead exemption).

69. Denham, *supra* note 45, at 274.

70. James W. Paulsen, *The Texas Home Equity Controversy in Context*, 26 ST. MARY’S L.J. 307, 309 (1994) (footnotes omitted). Paulsen takes a thorough and colorful look at the Texas homestead exemption throughout history. *Id.* at 309–18.

71. See WM. H. NUNN, A STUDY OF THE TEXAS HOMESTEAD AND OTHER EXEMPTIONS 2 (1931) (“Under the Spanish Law in force in Texas, prior to its independence of Mexico and for a short time thereafter, certain property was exempted from forced sale for the payment of debts.”); see generally Gerald E. Poyo & Gilberto M. Hinojosa, *Spanish Texas and Borderlands Historiography in Transition: Implications for United States History*, 75 J. AM. HIST. 393, 394–95 (1988) (examining historical accounts of Spanish control over Texas); Texas State Historical Association, Handbook of Texas Online, <http://www.tsha.utexas.edu/handbook/online/articles/TT/nptsd.html> (last visited Apr. 14, 2007) (chronicling Spanish and Mexican control of Texas in the early nineteenth century).

72. See NUNN, *supra* note 71, at 2–3 (discussing the history of Texas’s homestead protection under Spanish and Mexican control and in the Republic of Texas).

73. See *id.*

74. See *id.* at 3–4 (observing that Texas’s 1845 constitution contained homestead protection, which was maintained in the later 1861, 1866, and 1869 constitutions).

settlers to come to Texas.⁷⁵ In time it became an ever more forceful exemption through legislative reform and case law application.⁷⁶

Case law has been paramount in determining the boundaries of the homestead exemption, starting with the residency requirement.⁷⁷ Under Texas law, residency is conferred upon buying and designating a homestead in Texas.⁷⁸ Unfortunately for many, the homestead exemption initially benefited only families having both a husband and wife.⁷⁹ This restriction led to some seemingly unfair results, where the lack of a marriage was the basis for refusing the homestead.⁸⁰ The court noted this basic unfairness in *Renaldo v. Bank of San Antonio*, allowing a divorced father to declare a homestead exemption because of his relationship to his children, for whom he had an obligation to render support.⁸¹ Finally, in 1974, the Texas Legislature expanded the homestead exemption to include any single, adult person.⁸²

How much property does a Texas homestead include? In the Constitution of the Republic, the exemption included either 200

75. Paul Goodman, *The Emergence of Homestead Exemption in the United States: Accommodation and Resistance to the Market Revolution, 1840-1880*, 80 J. AM. HIST. 470, 476-77 (1993); see generally Hynes et al., *supra* note 22, at 19 (noting the role of settlement in the homestead exemption in Texas law).

76. See NUNN, *supra* note 71, at 2-3 (discussing the expansion of the homestead exemption through liberal reading).

77. See, e.g., *In re Peters*, 91 B.R. 401, 403 (Bankr. W.D. Tex. 1988) (holding that a debtor's property in Brazil was not exempt because "[e]xemption laws are local in their nature and have no extra-territorial force or operation"); *Mo. K. & T. Ry. Co. v. Swartz*, 115 S.W. 275, 276-77 (Tex. Civ. App.—Eastland 1909, no writ) (commenting that laws of exemption are "governed by the law of the forum" state); cf. *Wm. Cameron & Co. v. Abbott*, 258 S.W. 562, 564 (Tex. Civ. App.—Amarillo 1924, no writ) (concluding that a Texas debtor could not exempt the proceeds of the sale of his home in another state).

78. *Peters*, 91 B.R. at 404 (interpreting the statutory references to homestead as including only those located in Texas).

79. See NUNN, *supra* note 71, at 39 (reflecting that the exemption may have been primarily created for a family that included both a husband and a wife and observing its inapplicability to other types of households); see also J. THOMAS OLDHAM, TEXAS HOMESTEAD LAW 27 (1991) (noting that prior to 1974, only a "family" was protected and that the courts were often required to determine whether a household constituted a family).

80. See, e.g., *Renaldo v. Bank of San Antonio*, 630 S.W.2d 638, 638-39 (Tex. 1982) (reversing an appellate court decision that was based on the notion that a divorced father could not establish a homestead after his divorce); NUNN, *supra* note 71, at 24-25 (noting that the homestead protection did not extend to a household where a single man lived with and supported persons such as his ex-slave, cousin, or niece).

81. See *Renaldo*, 630 S.W.2d at 639-40 (reasoning that the relationship between the divorced father and son, and the father's intent to make it a home of his son, constituted grounds for entitling the father to homestead protections).

82. But see OLDHAM, *supra* note 79, at 27 (explaining that the urban homestead protection now extends to all adults, while there still exists some discrimination against single adults in the protection of rural homestead rights).

acres of rural land or \$2,000 worth of urban property.⁸³ The 1869 Constitution provided for the same rural exemption but increased the valuation of an urban homestead to \$5,000.⁸⁴ In 1970 the legislature increased the urban homestead to \$10,000.⁸⁵ The valuation process was problematic because it required the courts to decide whether or not to apply new values retroactively.⁸⁶ This forced the courts to engage in valuation and indicated that the value would have to be constantly adjusted upwards due to inflation.⁸⁷ In 1983 the Texas legislature changed the basis of an urban homestead to one premised upon the size of the lot.⁸⁸ This change also led to a question of retroactivity.⁸⁹ In *In re Barnhart*, the court held the new size requirements would supersede the valuation criteria regardless of when the homestead was established.⁹⁰ The court held that, as a matter of public policy, homestead exemption laws could be applied retroactively.⁹¹

As noted, the Texas homestead exemption has always contained at least two categories with different exemption limits. The Texas legislature initially defined an urban homestead as being within a city or town, and the rural homestead as being removed from municipalities.⁹² The legislature also defined a

83. TEX. CONST. of 1845, art. I, § 22, *reprinted in* OLIVER C. HARTLEY, A DIGEST OF THE LAWS OF TEXAS 73 (Philadelphia, Pa., Thomas, Cowperthwait & Co. 1850).

84. TEX. CONST. of 1869, art. I, § 15, *reprinted in* 2 GEORGE W. PASCHAL, A DIGEST OF THE LAWS OF TEXAS, 1124 (3d ed., Washington, D.C., W.H. & O.H. Morrison 1873).

85. *See* OLDHAM, *supra* note 79, at 13.

86. *See* Dallas Power & Light Co. v. Loomis, 672 S.W.2d 309, 310 (Tex. App.—Dallas 1984, writ ref'd n.r.e.) (holding that the framers of the 1970 amendment intended the law to be retroactive with regards to the amount of homestead exemption afforded).

87. *See* Wood v. Wheeler, 7 Tex. 13, 22 (1851) (commenting that placing a value on the homestead exemption is regrettable because property is subject to value fluctuations).

88. *See generally* OLDHAM, *supra* note 79, at 13 (discussing the change in the law allowing one acre of urban homestead regardless of its value).

89. *See In re Barnhart*, 47 B.R. 277, 279–80 (Bankr. N.D. Tex. 1985) (rejecting creditor's argument that retroactive application of the one-acre exemption was unconstitutional).

90. *Id.* at 280.

91. *Id.* at 281 (stating that “[t]o the extent that the amendment[] to the Texas homestead exemption protects the vital interests of citizens of this state, is remedial in nature, has a broad basis of underlying public policy and is consistent with the tradition of liberal construction of Texas exemption laws,” the retroactive application of the 1983 homestead amendment is constitutional).

92. *Compare* TEX. CONST. of 1845, art. I, § 22, *reprinted in* HARTLEY, *supra* note 83 (allowing the rural homestead exemption to protect land “not included in a town or a city”), *with* TEX. CONST. of 1869, art. I, § 15, *reprinted in* 2 PASCHAL, *supra* note 84 (adding “village” to the list that precludes claiming property as a rural homestead exemption). *See generally* TEX. CONST. art. XVI, § 51 (Supp. 2006); *In re Spencer*, 109 B.R. 715, 716–17 (Bankr. W.D. Tex. 1989) (holding that “country living” is not rural unless actively used to support the family). *Spencer* was later overruled, and the common law test requiring

third category of exemption that applied to the urban homestead: the business exemption.⁹³ At one point, Texas was the only state in the Union to protect a business interest as a separate component of the homestead.⁹⁴ Today the Texas Property Code defines this exemption as a subset of the urban homestead, and requires the business to occupy the same one acre of land that represented the upper-bounds of the urban exemption.⁹⁵ The urban exemption is ten acres and, although the ten acres can include a business, there is no separate business exemption.⁹⁶

Once the property at issue is identified, which portion will be exempt becomes a primary issue.⁹⁷ In *Mallou v Payne & Vendig*, the issue was whether the debtor should be allowed to designate which portion of the property would be deemed the homestead.⁹⁸ The trial court had ordered the forced sale of a 1.84 acre lot simply because it exceeded the one acre urban homestead.⁹⁹ Because the homestead comprised sixty percent of the property, the judge ordered sixty percent of the proceeds awarded to the debtor.¹⁰⁰ On appeal, the court determined that the debtor was entitled to pick the portion of her land to be designated as her homestead.¹⁰¹ Naturally, the designated portion would be the portion with the greatest value.¹⁰² If a

particular usage was rejected. *In re Bouchie*, 324 F.3d 780, 785 (5th Cir. 2003) (“[A]ll that is required for rural homestead purposes is that the property be used as a home.”); *see also In re Moody*, 862 F.2d 1194, 1200–01 (5th Cir. 1989) (interpreting the Texas Constitution and the Texas Property Code to allow a single adult only 100 acres in rural homestead exemption).

93. *See* TEX. PROP. CODE ANN. § 41.002(a) (Vernon 2000) (allowing an exemption for urban homes that are also used as a place of business).

94. *See* Jerry Patterson, *Home Equity Reform in Texas*, 26 ST. MARY’S L.J. 323, 326 (1995) (“Texas is the only state that includes business property in its homestead restrictions.”).

95. TEX. PROP. CODE ANN. § 41.002(a) (Vernon 2000); *see* *Davis v. Hawn Lumber Co.*, 193 S.W.2d 263, 265 (Tex. Civ. App.—Dallas 1946, no writ) (listing some of the well settled principles in determining homestead eligibility for the urban property exemption).

96. TEX. CONST. art. XVI, § 51 (Supp. 2006); TEX. PROP. CODE ANN. § 41.002(a) (Vernon 2000 & Supp. 2006).

97. *Cf.* *Mallou v. Payne & Vendig*, 750 S.W.2d 251, 256 (Tex. App.—Dallas 1988, writ denied) (concluding that the designation of the homestead within the estate is a matter for the courts to decide).

98. *Id.* (expressing a preference that in a partition the debtor should be “allowed to designate and segregate the one acre that she wanted to claim as her exempt property”).

99. *See id.* at 252–53 (describing the forced sale order and rationale of the trial court in the division of exempt and nonexempt proceeds).

100. *Id.* at 255–56.

101. *Id.* at 256 (holding that the trial court’s actions in forcing a sale of the entire property, followed by a postsale determination of the debtor’s homestead, contravened the homestead protections afforded by the Texas Constitution).

102. *Id.* (stating that the debtor would undoubtedly claim the more valuable portion of the homestead—the one acre that included the house). *But cf. In re Nerios*, 171 B.R.

forced sale was necessary, the value of that designated portion would go to the debtor.¹⁰³

In sum, since its inception, the homestead exemption has been maintained and “construed liberally” to the great benefit of property owners in Texas.¹⁰⁴ The most recent changes make it even more favorable because the exemption is bound only by acreage, with no monetary limit.¹⁰⁵ As currently written, the Texas Constitution is arguably one of the most protective of the homestead of any state, with only four other states boasting unlimited homestead exemptions.¹⁰⁶ Regardless of the value of the homestead, article 16, section 51 of the Texas Constitution precludes forced sale except for default on purchase money, taxes, and home improvement loans.¹⁰⁷ This homestead exemption encompasses improvements, leading to a “very liberal exemption” that may even be described as “extravagant.”¹⁰⁸ It is limited only by the fact that a debtor must choose either an urban or a rural homestead.¹⁰⁹

Unfortunately for proponents of a liberal homestead exemption, the federal homestead law was reformed by BAPCPA, which has been in effect since April 20, 2005.¹¹⁰ Before reviewing

224, 226 (Bankr. N.D. Tex. 1994) (disallowing a homestead exemption which included two homes).

103. See *Mallou*, 750 S.W.2d at 255–56 (discussing the fairness of the allocation of proceeds).

104. See *Wallis v. Wendler*, 65 S.W. 43, 45 (Tex. Civ. App.—Austin 1901, no writ) (holding that the right of the debtor to use of the property as a home is superior to the claim of a creditor); NUNN, *supra* note 71, at 11 (discussing the history of the liberal construction given the homestead exemption).

105. See TEX. CONST. art. XVI, § 51 (Supp. 2006) (omitting reference to monetary limits and providing an acreage-based limit).

106. Daniel Morman, *Judgment Liens, Homestead Exemptions and Involuntary Bankruptcies: Who Gets What After BAPCPA?*, 24 AM. BANKR. INST. J. 20, 20 (2005) (listing Florida, Texas, Iowa, Kansas, and South Dakota as the five states that presently grant an unlimited homestead exemption); *Is Doubling the Bankruptcy Homestead Exemption on the Horizon?*, 92 ILL. B.J. 290, 290 (2004) [hereinafter *Doubling the Exemption*] (noting that Illinois has a “miserably low” homestead exemption of \$7,500 for a single person and \$15,000 for a couple). Tennessee is at the other end of the homestead-protection spectrum. See *Brown*, *supra* note 31, at 180 (noting that Tennessee only provides a \$5,000 homestead exemption for individuals and \$7,500 for joint debtors).

107. TEX. CONST. art. XVI, § 51 & interp. commentary (Vernon 1993 & Supp. 2006) (indicating in Interpretive Commentary that releasing and refinancing liens does not create an additional burden on the property).

108. See, e.g., James L. Baker, Comment, *The Texas Homestead Exemption's Near Ban on Home Equity Lending: It's Time for the People to Decide*, 33 HOUS. L. REV. 239, 252 & n.85 (1996).

109. See *Davis v. Hawn Lumber Co.*, 193 S.W.2d 263, 265 (Tex. Civ. App.—Dallas 1946, no writ) (noting the limitation on the homestead exemption to either an urban or a rural dwelling, but not both).

110. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No.

the impact of this legislation on the Texas homestead exemption, a law and economics discussion of bankruptcy is in order.

III. A LAW & ECONOMICS VIEW OF BANKRUPTCY PROTECTION

A. *Governmental Regulation and the Free Market*

The debate over regulation of debt and bankruptcy is much like the debate over governmental regulation in general, with advocates of the law and economics school of thought positing that such regulation is usually inefficient.¹¹¹ Even when the purpose of regulation is benevolent, and even if now and again such regulation actually improves market efficiency, proponents of law and economics argue that regulation is inevitably futile, producing inefficiencies in the allocation of resources and creating market distortions.¹¹² Even so, America is replete with regulations that are used to shape the behavior of actors in such a way as to make that behavior more pleasing to society.¹¹³

The Texas “unlimited” homestead exemption demonstrates regulation gone too far.¹¹⁴ Governmental regulation has not been drawn as narrowly as possible, and given the propensity of politicians to over-regulate, the reforms of 2005 are welcome.¹¹⁵

109-8, § 1501(a), 119 Stat. 23, 216 (postponing most of the provisions of BAPCPA until October 2005, but activating provisions limiting homestead exemption immediately).

111. Bush, *supra* note 25, at 115 (“Followers of the school of thought known as Law & Economics . . . favor little, if any, intervention in any transaction they consider to be in the economic realm. For example, many law and economics followers view environmental regulation, antitrust, and corporate taxation as mechanisms which impede the ability of businesses to compete, turn a profit, and keep costs low.” (footnotes omitted)); *cf.* Richard A. Posner, *An Economic Theory of the Criminal Law*, 85 COLUM. L. REV. 1193, 1195 (1985) (“When transaction costs are low, the market is, virtually by definition, the most efficient method of allocating resources.”).

112. *See, e.g.*, Bush, *supra* note 25, at 115–16 (“Government intervention almost invariably leads to misallocation of resources, and inefficiency and distortion in the marketplace.”).

113. *See* Kenneth G. Dau-Schmidt, *An Economic Analysis of the Criminal Law as Preference-Shaping Policy*, 1990 DUKE L.J. 1, 1 (“The economic model of individual behavior is predicated on the assumption that people rationally choose among their opportunities to achieve maximum satisfaction according to their individual preferences. In accordance with this model, if a person’s opportunities or preferences change, then the opportunity the person chooses to satisfy her preferences will also change.” (footnotes omitted)).

114. *See, e.g.*, Julia Patterson Forrester, *Home Equity Loans in Texas: Maintaining the Texas Tradition of Homestead Protection*, 55 S.M.U. L. REV. 157, 174 (2002) (observing Congress’s criticism of the generosity of the Texas homestead exemption).

115. *Cf.* Bush, *supra* note 25, at 115–16 (noting the law and economics view that government regulation is inherently flawed and thereby suggesting that lawmakers should regulate as narrowly as possible).

The only question, from a law and economics point-of-view, is if they go far enough.

1. *Freedom to Contract Versus Public Policy.*

Exponents of [law and economics] argue that even if the goals of government intervention are laudable, these goals will go unfulfilled, because government intervention is an inherently flawed instrument of change that at best does nothing and at worse exacerbates the very problem attempted to fix. Government intervention almost invariably leads to misallocation of resources, and inefficiency and distortion in the marketplace.¹¹⁶

In a Posnerian heaven, the availability of any resource would be driven solely by market forces, resulting in the most efficient allocation of resources.¹¹⁷ Law and economics posits that the world is made up of rational persons who seek to maximize their own pleasure.¹¹⁸ To do so they will select from among the avenues open to them, via a series of rational, pleasure-maximizing choices.¹¹⁹ By definition, a trade is efficient when either both parties are better off, or one party would still be better off after compensating the other for his loss.¹²⁰ The market, without the perverse hand of the state, in most cases leads to the most efficient allocation of resources possible.¹²¹

This *homo economicus* understanding of the market is well suited to a strictly economic world, but easier to apply to some areas of the law than to others.¹²² The law and economics

116. *Id.*

117. See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 9 (6th ed. 2003) (asserting that resources tend to be used most optimally in a free market environment).

118. See *id.* at 4 (assuming that people seek to maximize utility in all areas of life, not just in their “economic” affairs); see also Darren Bush, *The “Marketplace of Ideas:” Is Judge Posner Chasing Don Quixote’s Windmills?*, 32 ARIZ. ST. L.J. 1107, 1111 (“According to economists, all human activity is a desire to maximize pleasure.”).

119. See Bush, *supra* note 118, at 1111 (discussing the preference maximization principle).

120. See generally POSNER, *supra* note 117, at 12–14 (discussing Pareto economics).

121. See generally *id.*

122. See Tanina Rostain, *Educating Homo Economicus: Cautionary Notes on the New Behavioral Law and Economics Movement*, 34 LAW & SOC’Y REV. 973, 976 (2000), for a primer on the homo economicus theory. See, e.g., Bush, *supra* note 118, at 1109 (“[A]s economics reached from its comfortable realm of markets and permeated other aspects of human behavior, the application of its first principles became attenuated. Instead of direct application of market principles to actual markets, economists turned their analyses toward what they perceived to be market-like activities. First Amendment law is such an example.” (footnotes omitted)); Anthony C. Coveny, *Introducing Heterogeneity into Models of Voting Behavior: The Differential Impact of Economic Perceptions Amongst Subgroups of the Electorate* (June 15, 2002) (unpublished Ph.D. dissertation, University

approach has been successfully applied to torts and contract law,¹²³ but is arguably more difficult to apply to areas such as criminal law,¹²⁴ same-sex marriage,¹²⁵ or religious freedom.¹²⁶ That said, the market for credit is, in practice, a subset of the contractual universe, with each buyer contracting for credit.¹²⁷ Ergo, the market is the best guarantor of efficiency—because the element of rational trade is encapsulated therein.¹²⁸

The purpose of contract law is to facilitate trading that is beneficial to both parties while reducing the risk of opportunism.¹²⁹ Understood as such, contracts are beneficial to society because they represent the voluntary trades that leave both parties better off.¹³⁰ In fact, the idea of contract is to improve upon the market by reducing externalities that inhibit exchange, i.e., the risk of breach.¹³¹ Contractual agreements, then, instill a greater sense of stability into the market by reducing transaction costs, making the promise of performance reliable, and facilitating deal making.¹³²

of New Mexico) (on file with the University of New Mexico Library). *But see* Richard A. Posner, *Free Speech in an Economic Perspective*, 20 SUFFOLK U. L. REV. 1, 2–3 (1986) (finding speech malleable to an economics analysis).

123. *See, e.g.*, GUIDO CALABRESI, *THE COSTS OF ACCIDENTS* 15–16 (1970) (examining accident tort law from the perspective of economic efficiency); Michael I. Meyerson, *The Efficient Consumer Form Contract: Law and Economics Meets the Real World*, 24 GA. L. REV. 583, 585 (1990) (using law and economics to explain contract law); *see also* Richard A. Posner, *A Theory of Negligence*, 1 J. LEGAL STUD. 29, 32–34 (1972) (presenting the case for a law and economics theory of tort). *But see* Gary T. Schwartz, *Reality in the Economic Analysis of Tort Law: Does Tort Law Really Deter?*, 42 UCLA L. REV. 377, 377–78 (1994) (exploring criticism of using law and economics to explain tort law).

124. *See generally* Posner, *supra* note 111, at 1194 (conceding, even while attempting to prove to the contrary, that the emphasis in criminal law “on the moral character rather than the consequences of behavior, suggests a decidedly noneconomic perspective”).

125. *See* Bush, *supra* note 25, at 116–17 (illustrating the inconsistent application of the law and economics analysis to same-sex, as opposed to traditional, marriage, and arguing that acceptance of same-sex marriage is “a sound economic principle”).

126. *See* Michael W. McConnell & Richard A. Posner, *An Economic Approach to Issues of Religious Freedom*, 56 U. CHI. L. REV. 1, 1–2 (1989) (“The application of economics to issues of religious freedom may seem an eccentric response to the inadequacies of current doctrine. Religious reasoning and religious faith may seem antithetical to economic reasoning and values . . .”).

127. *See generally* Ronald J. Mann, “Contracting” for Credit, 104 MICH. L. REV. 899, 907–10 (2006) (examining typical credit card agreements and noting the difficulties consumers face when entering into contracts for credit).

128. *See generally supra* notes 119–21 and accompanying text.

129. *See* POSNER, *supra* note 117, at 98 (summarizing the economic functions of contract law, including prevention of opportunism and allocation of risk).

130. *See* Bush, *supra* note 118, at 1113 (describing how social welfare is maximized when both buyers and sellers maximize their utility in the free marketplace).

131. *See* ROBERT COOTER & THOMAS ULEN, *LAW AND ECONOMICS* 227 (1988) (noting the purpose of contract law is to enforce promises made).

132. *See generally* THOMAS J. MICELI, *THE ECONOMIC APPROACH TO LAW* 109–12

However, not every contract should be enforced. This is the case in situations such as agreements reached under duress, through mutual mistake, or by a minor.¹³³ Although brevity precludes a discussion of each of these exceptions, the general principle is that contracts that are against public policy should not be enforced.¹³⁴ Suffice it to say, not every contract is allowed in society, and courts “must often balance competing ‘public policies,’ [and] must weigh one result against another.”¹³⁵ The market for credit is no different. The freedom to enter into a contract must always be weighed against public policy goals.¹³⁶ When the balance shifts to the protection of those goals, regulation is justifiable.¹³⁷

It is precisely for public policy reasons that Texas has a long history of protecting debtors who are unable to pay their debts.¹³⁸ Three of the articulated interests include preventing the individual from becoming dependent on the state, encouraging a sense of independence that operates as the foundation of a democracy, and encouraging colonization.¹³⁹ The freedom to enter into a contract for credit is preserved, but the enforcement of a breach is regulated such that when enforcement is counter to public policy goals, the courts will not enforce them.¹⁴⁰ “[T]o assist

(2004) (discussing such efficiency-related benefits of contracting).

133. See generally *id.* at 113–18 (analyzing various reasons for invalidating contracts).

134. See Walter Gellhorn, *Contracts and Public Policy*, 35 COLUM. L. REV. 679, 679 (1935) (“From early times, Anglo-American courts have refused to enforce illegal contracts, that is, those that are ‘opposed to public policy.’ As a rule, no substantial distinctions were made by the courts among situations where the contract bore an element of criminality . . . and where the contract was merely shocking to the sense of justice and of the fitness of things.”).

135. *Id.* at 690.

136. See, e.g., Eric A. Posner, *Contract Law in the Welfare State: A Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations of the Freedom to Contract*, 24 J. LEGAL STUD. 283, 285–309 (1995) (concluding that certain restrictions on the freedom to contract for credit are necessary to protect high-risk borrowers).

137. See Gellhorn, *supra* note 134, at 684–85 (suggesting that contracts that may be against public policy can be regulated through legislation, or by the courts’ refusal to enforce such contracts).

138. See Matthew J. Kemner, Comment, *Personal Bankruptcy Discharge and the Myth of the Unchecked Homestead Exemption*, 56 MO. L. REV. 683, 685–86 & n.10 (1991) (explaining the purposes of the longstanding Texas homestead exemption, including giving a debtor “some means . . . to recoup his economic losses so as to prevent the family from becoming a burdensome charge upon the public” (quoting TEX. CONST. art. XVI, § 50 interp. commentary (Vernon 1973))).

139. *Id.* at 686.

140. See Gellhorn, *supra* note 134, at 679 (noting that from early times, courts have refused to enforce contracts against public policy).

in their enforcement would be to encourage conduct which [is] inimical to the public welfare."¹⁴¹

These arguments in favor of bankruptcy protection may seem intuitive, but law and economics proponents would be careful to point out that governmental regulation is inherently dangerous.¹⁴² Every time the government regulates the free market, in this case the freedom to contract for credit, there are bound to be market effects.¹⁴³ Nowhere is this more evident than in the regulation of the credit market, where the breach of a contract for credit is shielded by law.¹⁴⁴ The near prohibition on home equity loans in Texas serves as a prime example. The section that follows looks at a debate over home equity loans in Texas that mirrors the larger debate over the bankruptcy homestead exemption. This debate is instructive because it demonstrates how prohibitive regulations serve to drive up the costs of credit.¹⁴⁵

2. *The Ban on Home Equity Loans.* It is difficult to determine the full impact of an unlimited homestead exemption on the credit market in Texas. Nonetheless, the debate over the wisdom of protecting the Texas homestead from forced sale in bankruptcy mirrors another debate that has raged for over a decade in Texas.¹⁴⁶ Until a decade ago, Texas prohibited home equity loans, and was the only state to do so.¹⁴⁷ The negative impact on limiting the collateral a Texan

141. *Id.*

142. See Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471, 1545 (1998) ("[T]he case for intervention is weakened to the extent that public institutions are likely to make things worse rather than better."); see also A.C. PIGOU, *THE ECONOMICS OF WELFARE* 300–02 (2d ed. 1924) (noting that public interference is not always warranted because intervention can just as easily exacerbate a problem as cure it); Bush, *supra* note 25, at 115 ("[G]overnment interventions in the market nearly always have negative effects on the marketplace, with very specific exceptions." (footnote omitted)).

143. See *supra* note 142 and accompanying text.

144. See *infra* Part III.A.2 (discussing the consequences of protecting the homestead on the credit market).

145. See Reint Gropp et al., *Personal Bankruptcy and Credit Supply and Demand*, 112 Q. J. ECON. 217, 219–20 (1997) (linking the protection of the homestead to increased credit costs based on the supply and demand of credit).

146. See generally Baker, *supra* note 108, at 245–47 (setting out both the economic interests and the personal issues on both sides of the home equity lending debate in Texas).

147. See David Hendricks, *Texas Seniors Soon May Be Able to Convert Home Equity Loans*, SAN ANTONIO EXPRESS-NEWS, Jan. 11, 2003, at 1D ("The Texas Legislature and Texas voters approved both home equity and reverse mortgages in a constitutional amendment in 1997, making Texas the last state to make these helpful, lower-interest loans legal."); see also TEX. CONST. art. XVI, § 50(t) (Supp. 2006) (allowing a home equity

can use to secure a lien is more transparent in the area of home equity loans.¹⁴⁸ In many ways the debate between the advocates of Texas's bar on home equity loans (generally consumer groups and advocates for the elderly) and its opponents (banks and financial institutions) mirrored the related debate over the unlimited homestead exemptions.¹⁴⁹

3. *The Debate over Texas's Prohibition on Home Equity Loans.*

The first prohibition on the forced sale of homesteads in Texas appeared in Texas statutes in 1839, before the state joined the union. This statute was adopted in reaction to a nationwide economic depression which became known as the Panic of 1837, when many families lost their farms and homes through foreclosure.¹⁵⁰

This same fear was even evident on the eve of its repeal, when many Texans feared losing their homes in the face of insurmountable debt.¹⁵¹ As a result of this concern, Texas remained the last state to allow home equity lending.¹⁵²

This ban, however, was an obstacle to those who wanted to put the equity in their homes to productive use.¹⁵³ Home equity loans are often the sole source of capital for many Americans.¹⁵⁴ This source of collateral can serve as a lifeline for an individual

line of credit to homeowners in Texas).

148. See Baker, *supra* note 108, at 246–48 (discussing the financial implications of the ban on home equity loans, including that the only way Texans could tap into their equity was to sell their home).

149. See *id.* at 246–47 (listing groups opposed to and in favor of home equity lending in Texas); Michael Totty, *Home-Equity Plan Fails to Win Converts*, WALL ST. J., Aug. 24, 1994, at T3 (introducing parties on opposite sides of the home equity debate).

150. Susan Combs, Texas Comptroller of Public Accounts, A Special Financial Report: Home Equity Lending, <http://www.cpa.state.tx.us/comptrol/homeeqty.html> (last visited Apr. 14, 2007).

151. TEX. FIN. COMM'N, RESEARCH INTO HOME EQUITY LENDING IN TEXAS: A SURVEY OF 1,201 TEXAS HOMEOWNERS 16 (1999), available at <http://www.fc.state.tx.us/heowners.pdf> [hereinafter *Homeowner Survey*] (reporting that nearly thirty-eight percent of Texans surveyed opposed allowing home equity loans in Texas because of the fear of foreclosure).

152. See Totty, *supra* note 149 (noting Texas is the only state with a strict constitutional ban on home equity lending); see also Kate Thomas, *Equity Backers Home in on Votes*, HOUS. POST, Oct. 30, 1994, at D1 (suggesting that as the only state to preclude home equity loans, Texas was “the untapped Holy Grail of home equity lending”).

153. See Baker, *supra* note 108, at 245 (noting home equity is a valuable source of capital for individuals).

154. See Linda M. Hooks, *Home Equity Lending Would Benefit Texas*, FIN. INDUS. ISSUES (Dallas), Fourth Quarter 1993, at 2 (“Home equity is the only source of collateral for most customers.”).

coping with financial difficulties.¹⁵⁵ Home equity also represents a source of economic potential because, at “the aggregate level, the economic consequences are staggering.”¹⁵⁶ The aggregate amount of Texans’ home equity has been estimated to be between \$136 and \$250 billion, and could translate into the infusion of between \$150 and \$260 million into the Texas lending market.¹⁵⁷ This infusion could generate \$5 billion for Texas’s economy and lead to the creation of 192,000 jobs.¹⁵⁸ In the aftermath of the repeal of this ban, there is evidence that this is exactly what is happening, with nearly ten percent of Texas homes tapping into this source of wealth in the first year following the repeal.¹⁵⁹

The ban on home equity loans is just one example of the government’s regulation of the lending market, purportedly to protect consumers from their propensity to overindulge in credit.¹⁶⁰ The end result, however, is inefficiency in the credit market leading to “higher interest rates and the foregone income tax deductions that are available for home equity borrowing.”¹⁶¹ This argument is analogous to the debate over the unlimited homestead exemption in Texas. As long as the homestead exemption is unlimited and sheltered from lenders, the cost of credit will be higher.¹⁶² Lenders may choose to avoid the Texas market

155. See *Home Equity Conversion: Issues and Options for the Elderly Homeowner, A Joint Briefing by the Subcomm. on Housing and Consumer Interests of the H. Select Comm. on Aging*, 99th Cong. 7 (1985) (statement of Don Bonker, Chairman, S. Comm. on Housing and Consumer Interests) (noting that for many elderly citizens, “homes represent their single largest asset”); see also Hooks, *supra* note 154, at 1–2 (explaining how home equity is a source of funding for debts, education, medical and other expenses).

156. Baker, *supra* note 108, at 247.

157. *Id.* at 247–48.

158. *Id.* at 248 (citing Terrence Stutz, *Ruling May Increase Home-Equity Loans*, DALLAS MORNING NEWS, May 4, 1994, at 1A (reporting an estimate of \$136 billion in equity in Texas)).

159. See *Homeowner Survey*, *supra* note 151, at 25 (reporting that an estimated 10.4% of Texas homeowners have applied for a home equity loan and 8.9% of Texas homeowners have actually obtained a home equity loan). The overwhelming number of uses for home equity loans were to pay off credit card or other debt, or for home improvement purposes. *Id.* at 31; see also TEX. LEGIS. COUNCIL, LEGISLATIVE REPORT, ANALYSIS OF HOME MORTGAGE DISCLOSURE ACT (HMDA) DATA FOR TEXAS, 1999–2001, 1 (2003), available at <http://www.fc.state.tx.us/Studies/mortgage-lending.pdf> (noting that the number of loan applications increased fifteen percent from 1999 to 2001).

160. See Totty, *supra* note 149 (discussing whether the new law contains sufficient safeguards for consumers).

161. Baker, *supra* note 108, at 248; see also Michael Allen, *Home Equity Loan: Case of Exaggerated Risks*, WALL ST. J., Jan. 26, 1994, at T1 (noting that interest is deductible from federal income tax—a deduction not available for traditional consumer credit); 26 U.S.C. § 163(h)(3)(C) (2000) (codifying the interest deduction); *cf. id.* § 163(h)(1) (“In the case of a taxpayer other than a corporation, no deduction shall be allowed under this chapter for personal interest paid or accrued during the taxable year.”).

162. See Baker, *supra* note 108, at 248 (asserting that Texans pay higher interest

altogether, may charge higher rates for credit when they do lend, may be forced to offer only high-interest unsecured loans, or may fail altogether due to their inability to recover debts that are sheltered by individual debtors in Chapter 7.¹⁶³ In short, because regulation can drive the cost of borrowing up, it behooves lawmakers to write this regulation as narrowly as possible.¹⁶⁴

4. *Strategic Behavior of Debtors.*

We've all heard the rationale for bankruptcy reform at cocktail parties and around the dinner table: Any deadbeat who runs up his bills can, before he pays up, run away and buy a house in Florida. The creditors can't touch his homestead What a windfall! Alas, the poor creditors are left wringing their hands with no recourse but to charge off their receivables from this unscrupulous vagabond.¹⁶⁵

Governmental regulation also changes the cost-benefit analysis of individuals engaging in the market.¹⁶⁶ The regulation "distorts" the market by creating a new set of rules.¹⁶⁷ One such distortion is the government's interference in the credit market, in the form of bankruptcy exemptions, which creates opportunities to shield assets by strategically relocating and undermines a primary economic function of contract law.¹⁶⁸ These opportunities are so stark that some economists, rather than questioning why so many are filing for bankruptcy, actually wonder why so few are moving to states with a generous homestead exemption.¹⁶⁹

rates because the homestead exemption reduces collateral securing their loans); *see also* Gropp et al., *supra* note 145, at 219–20 (noting that higher bankruptcy exemptions reduce the supply of credit, thus increasing the cost of credit).

163. *See* Gropp et al., *supra* note 145, at 234 (explaining the issues facing Texas lenders).

164. *See* Bush, *supra* note 25, at 115 (introducing the law and economics view that government should refrain from intervening in any economic transaction, because regulations have a negative effect on the marketplace).

165. Morman, *supra* note 106, at 20.

166. *See supra* Part III.A (discussing the inefficiencies associated with government regulation of the marketplace).

167. *See* Bush, *supra* note 25, at 115–16 (discussing the potential for distortion of the market when regulation goes too far).

168. *See* Ronel Elul & Narayanan Subramanian, *Forum-Shopping and Personal Bankruptcy*, 21 J. FIN. SERVICES RES. 233, 234 (2002) (stating that varying state exemption levels create "an incentive to move to a state with a higher exemption before declaring bankruptcy, that is to forum-shop"). *See generally* POSNER, *supra* note 117, at 98 (stating that the prevention of opportunism is one of the primary goals of contract law).

169. *See* Pomykala, *supra* note 37, at 9–10 (suggesting that many more households would benefit from bankruptcy than the number that actually file, wondering why the number of filers is actually so low, and citing one example of a beneficial filing from Florida where the state's 160-acre homestead exemption allowed a "former corporate raider" to retain a \$6 million mansion).

For this reason, bankruptcy is often described as a windfall for debtors.¹⁷⁰ Filers who relocate to Texas, California, Minnesota, Iowa, Kansas, and Florida just prior to filing are the most egregious of violators from a creditor's perspective, because they benefit unfairly from those states' liberal bankruptcy laws.¹⁷¹ Hence, "[c]redit card companies, banks, and other lenders . . . pushed hard for the changes say[ing] the new rules will stop abuses by spendthrifts who run up their debts and then walk away."¹⁷² Many of these walk away in Texas with their mansions intact.¹⁷³

The courts have not been blind to this type of strategic behavior. In *In re Sholdan*, the Eighth Circuit upheld the bankruptcy court's denial of a homestead exemption after finding that the debtor acquired the property with intent to defraud creditors.¹⁷⁴ In this case, Arthur Sholdan, after being named in a personal injury lawsuit, moved out of his assisted living situation and into a new home he purchased after liquidating all his assets, including savings.¹⁷⁵ He then declared bankruptcy under Chapter 7 exempting his home under the Minnesota bankruptcy law.¹⁷⁶ After his death, his estate unsuccessfully challenged the bankruptcy court's determination that the asset transfer had been an act to defraud and that a forcible sale of the home was warranted.¹⁷⁷

The actions by the Eighth Circuit Court here would seem enough to prevent strategic usage of homestead protection prior to

170. See *id.* at 10–11 (citing examples of debtors' attempts to abuse the bankruptcy system for financial gain).

171. See, e.g., Floyd Norris, *The New Bankruptcy Reform: Make the Rich Plan Ahead*, N.Y. TIMES, June 2, 2000, at C1 (discussing Bankruptcy Code abuse in states with then-unlimited homestead exemptions). See generally Jonathan B. Alper, P.L.C., *Moving to Florida, Becoming a Florida Resident for Homestead Protection*, http://www.alperlaw.com/moving_to_florida.html (last visited Apr. 14, 2007) (encouraging persons seeking to escape debt or liability in civil lawsuits to relocate to Florida, invest their money in a new Florida homestead, and reap the benefits of Florida law that provides immediate protection from creditors).

172. Kathleen Lynn, *New Chapter in Bankruptcy: Lenders See Rule as Fair; Lawyers Call Them Merciless*, RECORD (Bergen County, N.J.), Oct. 16, 2005, at B1.

173. *Id.*

174. See *In re Sholdan*, 217 F.3d 1006, 1010–11 (8th Cir. 2000) (applying a Minnesota statute, the Uniform Fraudulent Transfer Act, which specifically prohibited a debtor from claiming a homestead exemption via a fraudulent transfer). *But see In re Crater*, 286 B.R. 756, 770–72 (Bankr. D. Ariz. 2002) (criticizing the *Sholdan* opinion and holding that mere "timing factors [and] uneconomic decision-making by debtors" are not sufficient to prove fraud and deny an exemption).

175. *Sholdan*, 217 F.3d at 1010.

176. *Id.*

177. *Id.* at 1010–11 (affirming the bankruptcy court's determination that the debtor had acted with fraudulent intent).

the declaration of bankruptcy under Minnesota law.¹⁷⁸ However, even in *In re Sholdan* the court explicitly noted:

It is one thing to convert non-exempt assets into exempt property for the express purpose of holding it as a homestead and thereby putting the property beyond the reach of creditors. However, it is quite another thing to acquire title to a house for no other reason than to defraud creditors.¹⁷⁹

While the court found that acquiring title to a home as a pretext to hiding nonexempt assets may be deemed fraudulent when it represents a “radical departure”¹⁸⁰ from previous lifestyle, the court admittedly remained open to the idea of strategically sheltering nonexempt assets, leaving a door to abuse wide open.¹⁸¹

A similar case made its way through the Texas court system in *In re Bowyer*.¹⁸² Dr. Bowyer and his wife engaged in a rather well-planned process to put most of their assets into their homestead, constructing a greenhouse, adding furniture and belongings, and paying down the mortgage.¹⁸³ The bankruptcy court determined, and the district court agreed, that taking nonexempt assets and turning them into exempt assets did not preclude discharge.¹⁸⁴ In its first hearing of this case, the Fifth Circuit found sufficient evidence to infer intent to hinder and delay a creditor, even though there might not have been an intent to defraud.¹⁸⁵ Upon rehearing, however, the court reversed itself.¹⁸⁶

This case exemplifies the difficulty the courts have in drawing a line between “mere conversion of non-exempt property into exempt property on the eve of a bankruptcy,” on the one hand, and “transfers made to defraud, hinder or delay creditors” on the other.¹⁸⁷ Nevertheless, this difficulty was apparently anticipated by

178. *See id.* at 1008 (noting the statutory prohibition of a fraudulent transfer of property under Minnesota law).

179. *Id.* at 1011 (citation omitted).

180. *See id.* at 1010 (noting that the ninety year old debtor’s move to a new home after having lived in an apartment and an assisted care facility for more than thirteen years was a radical departure from his previous lifestyle).

181. *See id.* (“It is well settled that the mere conversion of non-exempt assets to exempt assets is not in itself fraudulent.”).

182. *In re Bowyer*, 916 F.2d 1056 (5th Cir. 1990), *rev’d on reh’g*, 932 F.2d 1100 (5th Cir. 1991).

183. *Id.* at 1057–58.

184. *Id.* at 1058.

185. *Id.* at 1059–60.

186. *See Bowyer*, 932 F.2d at 1102 (agreeing with the district court’s conclusion that the transfers were not “made to defraud, hinder, or delay creditors”); *see also In re Reed*, 700 F.2d 986, 991 (5th Cir. 1983) (“[M]ere conversion is not to be considered fraudulent unless other evidence proves actual intent to defraud creditors.”).

187. *Bowyer*, 932 F.2d at 1102.

the legislature, as the Fifth Circuit notes in *Bowyer* that the legislature had the opportunity to close off transfers of property on the eve of filing bankruptcy but refused to do so.¹⁸⁸ This point is also drawn out in the dissent in *Sholdan*, stating that the problem of homestead exemption is one for legislatures to tackle, not the court.¹⁸⁹ The dissent argued that the court should not become bogged down in deciding what level of homestead exemption would be needed to give a filer a “fresh start.”¹⁹⁰ The dissent concluded:

As to the injustice of allowing a debtor to escape his creditor so openly, the Court found that it was bound by well settled law to find no fraud without some extrinsic evidence of fraudulent intent. While Mr. Sholdan’s case may not be a sympathetic one, his exemption is allowed under Minnesota law, and, like the Supreme Court of Minnesota, we are bound to allow it to him regardless of our sense of its impropriety.”¹⁹¹

As the dissent in *Sholdan* might have predicted, the bar for fraud has seldom been applied to those who relocate to shield assets by acquiring a valuable homestead in a favorable state.¹⁹² In *In re Clements*, a creditor alleged that the debtor’s desire to defraud creditors was the driving factor in relocating to Florida.¹⁹³ Even so, the court refused to allow the newly acquired homestead to be targeted.¹⁹⁴ As long as the rules reward strategic filing, rational actors will utilize it.¹⁹⁵

188. *Id.*

189. *In re Sholdan*, 217 F.3d 1006, 1011–12 (8th Cir. 2000) (Arnold, J., dissenting).

190. *Id.* at 1012; *see also* *Norwest Bank Neb., N.A. v. Tveten*, 848 F.2d 871, 875 (8th Cir. 1988) (“[I]t is not fraudulent for an individual who knows he is insolvent to convert non-exempt property into exempt property, thereby placing the property out of the reach of creditors.”).

191. *Sholdan*, 217 F.3d at 1012 (Arnold, J., dissenting).

192. *See, e.g., In re Bowyer*, 916 F.2d 1056, 1060 (5th Cir. 1990), *rev’d on reh’g*, 932 F.2d 1100 (5th Cir. 1991) (finding that intent to hinder would suffice to disallow discharge but later reversing itself, and clarifying that mere conversion is not to be considered fraudulent).

193. *In re Clements*, 194 B.R. 923, 924 (Bankr. M.D. Fla. 1996) (noting that the debtor, a lifelong resident of Alabama moved to Florida and filed for bankruptcy soon after).

194. *Id.* at 927 (representing Florida’s settled law that fraud is not a bar to exempting the homestead); *see also In re Hendricks*, 237 B.R. 821, 825 (Bankr. M.D. Fla. 1999) (allowing the exemption regardless of the debtor’s fraudulent conversion of nonexempt assets to the homestead); *In re Young*, 235 B.R. 666, 672 (Bankr. M.D. Fla. 1999) (finding no fraud exception to the homestead exemption in the Florida Constitution “when real property is acquired for the sole purpose of defeating the claims of out-of-state creditors”); *Havoco of Am., Ltd. v. Hill*, 790 So. 2d 1018, 1030 (Fla. 2001) (representing Florida’s settled law that fraud is not a bar to allowing the homestead exemption).

195. *See* William Houston Brown & Lawrence Ponoroff, Essay, *A Second Look at the Proposed Uniform Bankruptcy Exemptions: Tennessee as an Example*, 28 U. MEM. L. REV. 647, 665–66 (1998) (including among the arguments for a national standard on homestead exemptions that a uniform standard would eliminate the incentive that varying limits

Forty-five states have legislated a cap on the value of the homestead.¹⁹⁶ Forty-nine have no exemption for a business.¹⁹⁷ But Texas has unlimited homestead protection for a residence that includes a business, provided, of course, that the entire property falls within the acreage requirements.¹⁹⁸ In addition, the Texas courts have liberally construed these exemptions.¹⁹⁹ This has led to strategic filings where the transaction costs of moving to Texas may actually be less than the perceived loss of filing in the original state.²⁰⁰ One way to curtail this strategic behavior would be to lower the homestead exemption in Texas to that of other states.²⁰¹ Another method, the one used in the BAPCPA, is to nationalize the exemptions.²⁰²

5. *Summary.* In a democracy, it is hard to argue that the incarceration and enslavement of the individual debtor should be permitted.²⁰³ Arguably, as a matter of public policy, the debtor should also be shielded from being completely defrocked of all her possessions.²⁰⁴ These concessions in hand, some form of regulation is

create to encourage people to relocate to states like Florida or Texas).

196. See Morman, *supra* note 106, at 20 (listing the five states where complete homestead protection is statutorily granted as Florida, Texas, Iowa, Kansas, and South Dakota).

197. See Patterson, *supra* note 94, at 326 (“Texas is the only state that includes business property in its homestead restrictions.”).

198. TEX. PROP. CODE ANN. § 41.002(a) (Vernon 2000).

199. See *supra* note 104 and accompanying text.

200. See Gropp et al., *supra* note 145, at 223 (distinguishing between typical debtors, who cannot afford to move to another state to file bankruptcy, and affluent debtors, who will find the transaction costs of relocating less than the perceived savings of doing so).

201. See Andreas Lehnert & Dean M. Maki, *Consumption, Debt and Portfolio Choice: Testing the Effects of Bankruptcy Law* 14 (FEDS, Working Paper No. 2002-14, 2005), available at <http://andreas.marginalq.com/Research/Bankruptcy1/dbtcon.pdf> (arguing that reducing the homestead exemption across America to that of the lowest quartile of states would reduce bankruptcy filings by as much as eighteen percent).

202. See 11 U.S.C. § 522(d)(1) (2006) (providing for a uniform national homestead exemption). *But see* Denham, *supra* note 45, at 273 (noting that the effect of BAPCPA’s uniform exemption is tempered by the opt-out provision, which “creates a disparate effect among debtors in different states if those states have different allowed exemptions from the bankruptcy estate”).

203. Cf. JAMES ANGELL MACLACHLAN, *HANDBOOK OF THE LAW OF BANKRUPTCY* 20–21 (1956) (noting that penal sanctions, when used under the old English law, were found to be ineffective at inducing debtor cooperation). See generally U.S. CONST. amend. VIII (providing protection against “cruel and unusual punishments”).

204. See John C. McCoid II, *Discharge: The Most Important Development in Bankruptcy History*, 70 AM. BANKR. L.J. 163, 163 (1996) (speculating on possible reasons that early bankruptcy law included a discharge feature, and noting that “discharge could be mutually beneficial to both debtors and creditors”); see also Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 10 (1995) (stating that the first bankruptcy law that included a discharge provision was introduced in England in 1705).

needed to ameliorate the costs of “going broke” to the individual and to society.²⁰⁵ The question then becomes: what level of property exemption is the optimal amount to preserve the integrity of the individual, while making the lender as whole as possible? This question is difficult to answer because the point of optimal balance is hard to ascertain with any precision. Bankruptcy laws impinge upon the freedom to contract for credit and curtail recovery in the event of a breach.²⁰⁶ This sort of regulatory scheme is not without consequences because it impacts open market exchanges.²⁰⁷ As bankruptcy laws make lending riskier by shielding those who breach, the costs of credit rises.²⁰⁸ Further, opportunists, who might be least in need of the state’s protection, may be best situated to take advantage of the state’s protection.²⁰⁹

B. Does the Bankruptcy Law in Texas Go Too Far?

1. *The Cost of Credit.* As the discussion of Texas’s ban on home equity loans implies, the relationship between creditors and consumers is different in states where liens cannot attach to the homestead from those in states where they can.²¹⁰ Where a consumer might get a loan in another state, at a price and for a purpose they deem rational, in Texas this loan may either be unavailable or cost significantly more.²¹¹ This is true for two reasons. First, those with excess, idle funds are less likely to want to

205. See *supra* notes 9–14 and accompanying text (describing the ways the Bankruptcy Code provides the debtor with a “fresh start”); *supra* notes 43–45 and accompanying text (discussing the burdens imposed on society when a debtor becomes hopelessly insolvent).

206. See Gropp et al., *supra* note 145, at 219–20 (commenting on how bankruptcy exemptions impact credit markets).

207. See PIGOU, *supra* note 142, at 331–33 (noting that public interference in every problem is not always warranted because intervention can just as easily exacerbate a problem as cure it); see also Bush, *supra* note 118, at 1116–17 (explaining how open market exchanges produce negative and positive externalities).

208. Cf. Posting of Richard Posner, *The Bankruptcy Reform Act*, to THE BECKER-POSNER BLOG, (Mar. 27, 2005, 14:20 EST), http://www.becker-posner-blog.com/archives/2005/03/the_bankruptcy.html (asserting that bankruptcy protection makes lending riskier and thus makes credit more costly, and concluding that “[c]ritics have derided the [BAPCPA] as mean-spirited and hard on the poor, but they overlook the most important effect that the bill is likely to have, and that is to reduce interest rates”).

209. See *supra* notes 170–73 and accompanying text.

210. See Lee Robert Bogdanoff, Comment, *Exemptions Under the Bankruptcy Code: Using California’s New Homestead Law as a Medium for Analysis*, 72 CAL. L. REV. 922, 922–23 (1984) (noting that the sharp division in bankruptcy courts about which law applies in opt-out states adds uncertainty, making it more difficult for creditors to extend credit to consumers).

211. See Gropp et al., *supra* note 145, at 234 (explaining that borrowers in states like Texas cannot borrow, are discouraged from borrowing, or must pay higher interest because of the unlimited homestead exemption).

put that cash into circulation because they are risk-averse.²¹² Second, there is a loss of production for the individual who seeks to get the loan but is unable to do so.²¹³ The borrower may want to build, purchase goods and services, or invest in a new business.²¹⁴ By denying the holder of valuable property the right to leverage that property for the use of capital, the regulatory scheme either denies the holder credit or forces the holder to contract for credit at a higher, unsecured rate.²¹⁵

These side effects must be viewed when looking at the problem an unlimited homestead exemption was meant to ameliorate. If the public policy is that consumers will be left without a means of making a living, the other side of the equation must also be examined. What about those who have a means to make a living but are precluded from doing so because the regulation reaches too far? Regulations are not purely exogenous factors; hence, much like cutting-edge medicine, they must be viewed not only for their curative properties, but also for the side-effects they cause.²¹⁶ An unlimited homestead exemption makes it more costly for lenders to engage in business in Texas, and thus makes every Texan pay more for the credit they want.²¹⁷

2. *Is an "Unlimited" Exemption Necessary?* Is there a need for an unlimited homestead exemption? The answer to this lies in two goals that are at odds. On the one hand is the need to encourage contract compliance.²¹⁸ The cost of declaring bankruptcy must be sufficiently high to produce an incentive to comply with the contract to repay debt.²¹⁹ Otherwise, contract law is bereft of

212. See Posner, *supra* note 208 (noting that risk is central to the cost of credit).

213. See Baker, *supra* note 108, at 245 & n.46 (illustrating how home equity loans free dormant capital to become useful and active capital).

214. See U.S. DEP'T. OF HOUS. AND URBAN DEV. & U.S. DEP'T OF TREASURY, CURBING PREDATORY HOME MORTGAGE LENDING: A JOINT REPORT 2-3 (2000), available at <http://www.huduser.org/Publications/pdf/treasrpt.pdf> (explaining that lending allows borrowers to "buy new homes, improve their homes, or access the equity in their homes for other purposes"); see also *supra* notes 154-55 and accompanying text (noting how homeowners can put the equity in their homes to productive use).

215. See Posner, *supra* note 208 (explaining that limiting the amount of capital available for lending, by increasing the risk of lending, raises the costs of credit).

216. See *supra* Part III.A (acknowledging that government regulations have the potential to worsen matters).

217. See Posner, *supra* note 208 (noting the higher cost of credit when bankruptcy filing is easier and more rewarding); see also Mark Calvey, *Texas Could Be Loan Star State for BofA, Wells*, S.F. BUS. TIMES, July 25, 1997, at 3 (discussing how the nation's banks are primed to engage in more activity in Texas if given a more favorable lending landscape).

218. See generally POSNER, *supra* note 117, at 93-98 (discussing the desire to enforce contracts unless a breach is economically advantageous).

219. See Joshua Cender, *Knocking Opportunism: A Reexamination of Efficient*

purpose to minimize risk.²²⁰ There is a well-known concept in contract law called the efficient breach.²²¹ Using a different basis than the morality of keeping a promise, the efficient breach concedes that the price of breaching a contract is always a part of the calculus of compliance.²²² When an offer comes along that more than compensates an individual for the breach of a current contract, that individual is acting rationally to breach it.²²³ Under this rubric, bankruptcy must be sufficiently costly that compliance is usually rational, and only those who fall on such hard times that the breach is an efficient escape route will avail themselves of such a costly procedure.²²⁴

The second goal is encapsulated in the “fresh start” mantra. This goal has two purposes: letting individuals retain enough resources to avoid the costly externalities to society, and enabling them to lead productive lives.²²⁵ Looking at each in turn, the first is economically essential. The common example of pollution demonstrates that there are times when the costs to society should be internalized by either the producers or the consumers.²²⁶ There are externalities to allowing an individual to be completely stripped of all worldly possessions.²²⁷ Homelessness, children as wards of the state, and hospital rooms full of people with no resources, are the sorts of externalities that regulations should seek to internalize.²²⁸

Breach of Contract, 1995 ANN. SURV. AM. L. 689, 689–90 (advancing that the cost of breaching a contract must be high enough to reimburse the nonbreaching party).

220. *Id.* at 704–05 (recognizing that risk aversion is one component of contract law that must be incorporated in the compensation for breach).

221. *See* MICELI, *supra* note 132, at 128–44 (detailing the components of the efficient breach model).

222. *See generally* Cender, *supra* note 219, at 697–705 (examining economic justifications for efficient breach).

223. *See* POSNER, *supra* note 117, at 120 (instructing that a breach is efficient only when the breach profit exceeds the contract profit of the breaching party and the nonbreaching party combined).

224. *Cf.* Gropp et al., *supra* note 145, at 223 (discussing costs to debtors that should be considered prior to filing).

225. *See supra* notes 9–14 and accompanying text (describing how bankruptcy laws in the United States foster the goal of providing the debtor with a “fresh start”); *supra* notes 43–45 and accompanying text (noting the cost to society when debtors are unable to support themselves).

226. *See generally* R. H. Coase, *The Problem of Social Cost*, 3 J. LAW & ECON. 1, 1–2 (1960) (discussing the “reciprocal nature of the problem” of who bears costs and providing several illustrative examples, including pollution).

227. *See, e.g.*, John M. Quigley, *The Homeless*, 34 J. ECON. LIT. 1935, 1936 (1996) (reviewing BRENDAN O’FLAHERTY, *MAKING ROOM: THE ECONOMICS OF HOMELESSNESS* (1996)) (noting externalities imposed on society by homelessness).

228. *See* PIGOU, *supra* note 142, at 300 (arguing that societal costs should be internalized through governmental regulation when resources are not allocated “in the best interest of the national dividend”).

The second purpose, by contrast, is more theoretical. How much does a person need to return to a life of productivity? Does a person require a certain dollar amount of property? Should a business be exempt so that persons, post-bankruptcy, can quickly return to being productive members of society? Apparently, only Texas feels this is the case.²²⁹ Is a fresh start contingent upon ownership of a home, regardless of its size? What about an individual who gets an exemption on a three million dollar home? What about the apartment dweller who has no homestead exemption to claim? How does this compare to a person who gets to keep a home and a small business after declaring bankruptcy?

How this balance should be reached is problematic because there is no clear consensus, as evinced by the fact that “debtors receive a different economic fresh start depending upon their state citizenship.”²³⁰ In Texas, a homestead is fully protected for any value, even millions of dollars, while in Tennessee and Illinois the homestead is protected only to the tune of \$7,500.²³¹

As contended in the dissent in *Sholdan*, the amount of the exemption is a question for the legislature.²³² However, from an economic point of view, the exemption ought to reflect the most narrow regulation possible.²³³ A minimal exemption would avoid pushing the cost of credit higher than necessary and prevent strategic filing by opportunists. An unlimited exemption, on the other hand, goes too far in the former and encourages the latter. There is no logic in allowing a single individual to remove millions of dollars in assets from the reach of creditors to secure for that individual a “fresh start.” These assets, once removed, are a transaction cost that must now be passed on to consumers elsewhere.²³⁴ Likewise, the irregularity of state laws allows for those

229. See *supra* notes 93–96 and accompanying text (discussing the history of the separate business exemption in Texas and the current exemption covering urban homes used for business purposes); see also Fan & White, *supra* note 33, at 543–44 (arguing for higher levels of homestead exemption to encourage entrepreneurial activity and provide “wealth insurance” that makes risk taking more viable for small business owners).

230. Brown, *supra* note 31, at 180 (commenting on “state homestead exemptions, as well as . . . other significant exemptions”).

231. See *id.* (noting the interstate disparity in that, for example, Tennessee provides up to a \$7,500 homestead exemption for joint debtors); *Doubling the Exemption*, *supra* note 106 (listing the homestead protection in Illinois as \$7,500 for joint filers).

232. See *supra* note 189 and accompanying text.

233. See Bush, *supra* note 25, at 115–16 (noting that regulation should be drawn as narrowly as possible); see also Cender, *supra* note 219, at 705–18 (discussing the costs of breach and arguing that the full costs of breaching a contract should be internalized to prevent excessive opportunistic breach).

234. See Gropp et al., *supra* note 145, at 219 (comparing the homestead exemption to insurance).

with a great deal of assets to take advantage of the leniency in states like Texas.²³⁵

3. *Establishing a National Standard.* The U.S. Constitution gives Congress the authority to dictate bankruptcy laws.²³⁶ A national standard would remove the incentives to engage in opportunistic filing.²³⁷ Additionally, a national standard would reduce unlimited exemptions in states like Texas and increase the amount of the exemption in states like Michigan.²³⁸ In theory, BAPCPA does accomplish these two goals, though in practice the results may be less compelling.²³⁹

IV. THE WINNERS AND LOSERS OF THE NEW BANKRUPTCY LAW IN TEXAS

A. *The Changes That Will Affect Texans' Homestead Exemption*

The reforms that went into effect on April 20, 2005, include a reduction in the homestead exemption to \$125,000.²⁴⁰ This reduction supersedes state law, affecting home owners in states where the homestead exemption is more expansive, especially in states like Texas, Florida, and California with unlimited homestead exemptions.²⁴¹ A very important caveat, however, is the temporal element of BAPCPA, which only applies to property that has been owned for less than forty months.²⁴² The impact of this temporal restriction will be discussed below.

235. See *id.* (recognizing a large disparity in the homestead exemption between states like Iowa and Texas).

236. U.S. CONST. art. I, § 8 (giving Congress the power to establish “uniform Laws on the subject of Bankruptcies throughout the United States”); see also THE FEDERALIST NO. 42, at 239 (James Madison) (Clinton Rossiter ed., 1961) (“The power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce, and will prevent so many frauds where the parties or their property may lie or be removed into different States, that the expediency of it seems not likely to be drawn into question.”).

237. See *supra* Part III.A.3 (discussing the strategic and opportunistic shielding of assets by relocating to states with higher homestead exemptions).

238. See Hynes et al., *supra* note 22, at 26 tbl.1 (showing Michigan’s homestead exemption of only \$7,000 as the lowest in America).

239. See *infra* Part IV (emphasizing that the federal homestead exemption of \$125,000 only applies to property owned for less than forty months).

240. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 322(a), 119 Stat. 23, 96 (codified as amended at 11 U.S.C. § 522 (2006)).

241. See *supra* note 196 and accompanying text (listing five states that have unlimited homestead exemptions).

242. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 322(a), 119 Stat. 23, 96 (codified as amended at 11 U.S.C. § 522 (2006)) (applying the \$125,000 federal homestead exemption limitation only to properties designated as a homestead for 1,215 days or less, thus allowing state exemptions if the property is owned

B. The Winners and the Losers of the Newly Reduced Homestead Exemption

1. *The Winners.* Creditors are the most notable winners.²⁴³ The reformed bankruptcy law differs from the previous law along two lines. First, the new federal law preempts state laws in stark contrast to the “opt-out” provision allowed in the 1978 Bankruptcy Code.²⁴⁴ Thus, the regulation of bankruptcy, given to the federal government in the Constitution, is now being given (nearly) full force. Certain elements of the new Code are meant to curtail filings, and to make some filers repay at least part of their debt.²⁴⁵

Second, the new federal homestead exemption caps previously unlimited exemptions in several states.²⁴⁶ The once-unlimited homestead exemption in Texas is now capped at \$125,000.²⁴⁷ Under the new law, once the valuation of the homestead is determined, any amount in excess of \$125,000 is now available to creditors and may induce a forced sale.²⁴⁸ Certainly, a creditor at the end of the line is still less likely to recover than a creditor at the front of the line, but the larger pot now allows more satisfaction down the line until the assets are drained. This means a reduction in the risk of lending which translates into a reduction in the cost of credit.²⁴⁹

Also among the winners are the consumers of credit who are not in peril of filing for bankruptcy. This is true because adding to the pot of assets that can be taken in a bankruptcy to recover outstanding debts, and making it harder for others to file, should

for more than 1,215 days).

243. Warren, *supra* note 3 (observing that the credit industry pushed the hardest for—and will benefit the most from—the bankruptcy reforms).

244. See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 322(a), 119 Stat. 23, 96 (codified as amended at 11 U.S.C. § 522 (2006)) (stating that even when electing to exempt property under state or local law, a debtor may not exempt any amount that exceeds \$125,000 in value); see also Pub. L. No. 107-204, 92 Stat. 2549, 2587 (1978) (providing that states can specifically opt out of the federal exemption); *supra* notes 54–56 and accompanying text (discussing the opt-out provision of the 1978 law).

245. See Morman, *supra* note 106, at 20 (explaining that the new “means test” provision in BAPCPA might prevent some debtors from filing under Chapter 7, forcing them to file under Chapter 11 or 13).

246. See Hynes et al., *supra* note 22, at 26 tbl.1 (listing seven states with unlimited homestead exemptions in 1996 that are now subject to the federal \$125,000 limit).

247. See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 322(a), 119 Stat. 23, 96 (codified as amended at 11 U.S.C. § 522 (2006)) (listing the maximum exemption allowed, regardless of state limits, at \$125,000).

248. *Id.*; see Morman, *supra* note 106, at 20 (noting the possibility under BAPCPA of a creditor satisfying debt through a forced sale of the debtor’s homestead).

249. See *supra* note 145 and accompanying text (showing that an unlimited homestead exemption increases credit costs).

drive the cost of credit down.²⁵⁰ With debt easier to collect, the probability of recovery goes up; hence, the availability of funds increases. As with any commodity, as the supply increases the price decreases.²⁵¹

2. *The Losers.*

[T]he new law will have “a profound negative effect . . . If debtors aren’t going to be able to get a fresh new start, not only is it bad for our economy but it’s bad for the non-bankrupt sector . . . You’re going to have people going into the underground economy, not paying their taxes; they’ll be dispirited and there will be more crime.”²⁵²

a. Recent purchasers. The losers will be those who have lived in their homestead for less than the forty month requirement and have more than \$125,000 of equity in their home.²⁵³ This may include for instance, recent first-time purchasers, those who have not had a homestead in the last ninety days, and those who may have recently divorced. This group does not represent opportunistic filers, but, nevertheless, their homesteads are caught under federal law.²⁵⁴ Those who have lived in their homesteads for over the forty month period can still utilize the state exemption limits or complete exemption.²⁵⁵ Likewise, any filer who has less than \$125,000 equity in her home is also unaffected.²⁵⁶

b. Opportunists. This leads us to those filers who will lose much of the incentive that made strategic filing appealing under the old law. This is a big boon to advocates of eliminating opportunistic filing. Those who seek to file, but have owned their homestead for

250. See Posner, *supra* note 208 (analyzing how the bankruptcy reform will lower interest rates on consumer debt).

251. See Gropp et al., *supra* note 145, at 219–20 (commenting on how the homestead exemption affects the supply and demand of credit).

252. Lynn, *supra* note 172 (quoting Kenneth Klee, UCLA Law Professor).

253. See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 322(a), 119 Stat. 23, 96 (codified as amended at 11 U.S.C. § 522 (2006)) (capping the federal homestead exemption to \$125,000, but only for filers with homesteads designated within the last 1,215 days).

254. See Gropp et al., *supra* note 145, at 220 (commenting that the typical filer is not one who has a great deal of wealth, but one with relatively little equity in his home, precluding him from the advantages of strategic filing).

255. See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 322(a), 119 Stat. 23, 96 (codified as amended at 11 U.S.C. § 522 (2006)) (allowing persons who have declared a homestead for a period longer than 1,215 days to utilize higher state exemption limits).

256. See *id.* (limiting the amount of exemption to \$125,000, and thereby making moot any appeal to state law for those who have less equity in their homestead).

less than forty months, are forced to utilize the federal limit of \$125,000.²⁵⁷ Again, if the equity is lower than the \$125,000, the reforms are immaterial.²⁵⁸ But, for many strategic filers, the whole purpose is to shield a greater amount of money from creditors than they could under their state law.²⁵⁹ Now they are not able to do so unless they relocate for forty months prior to filing, thereby greatly increasing the cost of relocation for filing.²⁶⁰

c. Why the losers are fewer than might be expected. Although both recent purchasers and opportunistic filers are hurt by the new reforms, there are reasons to note that they represent a relatively small group of filers overall. Over the first four years of ownership, most new buyers have little equity in their homes.²⁶¹ This is especially true of those who are not wealthy, and whose filing is often precipitated by catastrophic health issues, loss of a job, or divorce—three things that many unrealistically fail to consider as possibilities when they contract for credit.²⁶² Because parents often underestimate the expense of children, status as a parent is now the single biggest predictor of financial collapse.²⁶³ In fact, “married couples with children are more than twice as likely to file for bankruptcy as their childless counterparts.”²⁶⁴ Likewise, a single mom is three times as likely to file as her single counterpart with no children.²⁶⁵ These individuals are the least likely to have accrued equity in their home at the time of filing,²⁶⁶ and arguably

257. *Id.*; see also *supra* note 253 and accompanying text.

258. See *supra* note 256 and accompanying text.

259. See *supra* notes 169–70 and accompanying text (illustrating examples of opportunistic filing).

260. See *supra* note 253 and accompanying text; see also Groppe et al., *supra* note 145, at 219 (noting that the avenue open to strategic filers is only beneficial if the costs of relocating are less than the perceived benefits).

261. Cf. Federal Reserve Board, Interest-Only Mortgage Payments and Option Payment ARMs, http://www.federalreserve.gov/pubs/mortgage_interestonly/ (last visited Apr. 14, 2007) (“During the first few years of a traditional mortgage loan, most of your monthly payment goes to interest. The rest goes toward the principal, so that you start to build equity in your home through payments.”).

262. See Jacoby et al., *supra* note 16, at 377 (noting how health problems often leave people financially vulnerable); see also Elizabeth Warren, *The Growing Threat to Middle Class Families*, 69 BROOK. L. REV. 401, 402–03 (addressing the nexus between divorce or having children and the chances of filing for bankruptcy).

263. See Warren, *supra* note 262, at 402 (revealing that households with children are often in “the worst financial trouble”).

264. *Id.*

265. *Id.*

266. See Bankrate.Com, The Basics of Private Mortgage Insurance (PMI) (June 1, 2001), <http://www.bankrate.com/brm/news/mtg/20010601b.asp> (recognizing that few are able to put up even twenty percent of a home’s value at purchase).

the least likely to be able to expend the resources to move to another state to take advantage of opportunistic filing.²⁶⁷

These concessions in hand, the new law targets many fewer individuals than it might appear. Nonetheless, opportunistic filers have reaped the ire of proponents of bankruptcy regulation, as clearly evinced in the name of the new reforms, “Abuse Prevention.”²⁶⁸ For these filers, an efficient breach is much more difficult to find. For others seeking to file for bankruptcy, they may also engage in opportunistic filing by holding off for a few years.

3. *The Texas Credit Market.* The intent of the new reforms was to remove the unlimited homestead exemption, but this has not been accomplished because the new legislation has a temporal element that precludes this impact.²⁶⁹ As noted above, the Texas unlimited exemption is still available to those who file after owning a Texas homestead for more than forty months. Instead of a grandfather clause that would exempt persons who already own a homestead in Texas, the law allows any person who owns a homestead for at least forty months to avail themselves of Texas’s generous exemption.²⁷⁰ This eviscerates the possibility of the lower homestead exemption improving the availability of credit.

V. CONCLUSION

BAPCPA restores greater efficiency to the credit market in Texas. The ideological winners are the advocates of bankruptcy reform and proponents of law and economics.²⁷¹ The credit card companies, banks, and other lenders have won a victory along many lines—the reduction in the number of individuals who can file for Chapter 7, the mandatory credit counseling for filers, and even in the reduction of the homestead exemption in states like Texas (albeit with an important temporal caveat).²⁷² The lobbyists for the credit industry and the advocates of law and economics have

267. Cf. Scott W. Allard & Sheldon Danziger, *Welfare Magnets: Myth or Reality?*, 62 J. POL. 350, 363 (2000) (concluding that single parents do not move frequently, and when they do it is for reasons other than taking advantage of a state’s welfare benefits).

268. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 1(a), 119 Stat. 23, 23.

269. See *supra* note 253 and accompanying text (observing that Texas debtors can bypass the new federal homestead exemption if they have lived in their home for more than forty months).

270. *Id.*

271. See *supra* Part III.A. (describing how the new federal homestead exemption pleases proponents of both bankruptcy reform and of law and economics).

272. See *supra* note 7 and accompanying text (discussing how the ease of filing for bankruptcy discourages people from looking at alternatives such as refinancing).

reduced the artificial regulation of credit to the benefit of both lower credit and better recovery.²⁷³

On the practical side, the winners and losers are fewer than might have been the case. The new law still reflects the compromises made in The Bankruptcy Act of 1978.²⁷⁴ The jury is still out on if the change will, in fact, produce lower costs of credit in Texas. Many filers would be wise to hold off filing until they have been in their homestead for at least the forty months required for utilizing the complete homestead protection provided by Texas law. Likewise, although opportunistic filing ought to be diminished, this will be unlikely to reduce credit costs in Texas significantly because, though notorious, they represent a small portion of filers.²⁷⁵

In the aftermath of the new law, there are both genuine and opportunistic losers. Yet, it remains to be seen whether and to what extent the 2005 Act will affect the balance of often-competing interests of debtors and creditors.²⁷⁶ It looks like creditors and advocates of law and economics will perhaps have to wait for the next big reform before finally burying the unlimited homestead exemption in Texas.

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273. See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 106, 119 Stat. 23, 37 (codified as amended at 11 U.S.C. § 109 (2006)) (mandating that all debtors seeking to file bankruptcy receive credit counseling from an approved nonprofit budget and credit counseling agency).

274. See *supra* note 56 and accompanying text (recognizing that the ability of states to opt out of the federal homestead exemption diminishes its effects).

275. See *supra* note 262 and accompanying text (observing that the typical filer is not the affluent person trying to evade creditors, but the person who is having financial difficulties).

276. See Roxane DeLaurell & Robert Rouse, *The Bankruptcy Reform Act of 2005: A New Landscape*, C.P.A. J. ONLINE, Nov. 2006, <http://www.nysscpa.org/cpajournal/2006/1106/essentials/p36.htm> (suggesting that only time will tell how the 2005 Act will change the creditor-debtor landscape).