

# The History and Future of Michigan Debtor Exemptions

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By Thomas R. Morris

Michigan has both a general debtor-exemptions statute and a bankruptcy-specific statute. The bankruptcy-specific exemptions, MCL 600.5451, have been held unconstitutional. The general judgment-debtor exemptions, MCL 600.6023, have not kept pace with inflation or with changes in property ownership.

This article examines the history of Michigan and federal bankruptcy exemption law and examines the options for changes to Michigan's law.

## Territorial Laws

In 1787, with the enactment of the Northwest Ordinance, what is now Michigan became part of the "Territory of the United States northwest of the River Ohio." In 1805, Michigan achieved status as a territory.

Michigan's territorial government soon adopted laws on debtor-creditor relations, but the laws of Michigan's pioneer days had a haphazard quality. One of the first laws enacted in 1805 by the new territorial government concerned debtors imprisoned for debt. A debtor who had been discharged from debtor's prison was allowed the following exemptions with respect to future collections by his judgment creditors:

his wearing apparel and household furniture necessary for himself, his wife and children, and tools necessary for his trade or occupation....<sup>1</sup>

In 1807, an exemption of just "one cow and one sheep" was provided with respect to judgments issued by district courts.<sup>2</sup> The first general exemption law was enacted in 1809, which allowed for more sheep but did not provide a "tools of the trade" exemption found in the law providing for a discharge from debtor's prison:

one cow and ten sheep, and such suitable apparel, bedding, tools, arms, and articles of household furniture as may be necessary for upholding life....<sup>3</sup>

In 1810, the court system was altered.<sup>4</sup> Exemptions related to judgments issued by justices (whose jurisdiction replaced that of the dis-

trict courts) were stated with yet another variation.<sup>5</sup> Another 1809 law provided for an exemption not referenced in contemporaneous acts on the subject. "Arms, ammunition and accoutrements," required under an 1809 militia law to be kept by "every free, able bodied white male inhabitant" were exempt under that militia statute.<sup>6</sup> That exemption, unlike the militia, remains in effect.

Later versions of the territorial exemption provisions show evidence of more legislative care, but the list of exempt property shifted every few years. In 1821, the law concerning executions became more detailed.<sup>7</sup> The 1821 law was more generous, allowing, for example, for twenty sheep, provisions necessary for one year, and a detailed variety of books.<sup>8</sup> In 1825, the exemptions enacted in 1821 were expanded.<sup>9</sup> In 1827, the number of sheep was trimmed to ten.<sup>10</sup> A separate statute "for the relief of insolvent debtors" was enacted on the same date in 1827, yet it provided less comprehensive exemptions for debtors subject to its provisions.<sup>11</sup> In 1828, the 1825 exemptions were revived with respect to claims that accrued prior to January 1, 1828, and different exemptions were made applicable to claims that accrued after January 1, 1828.<sup>12</sup> No provision was made for claims that accrued on January 1, 1828. In 1833, this temporal dichotomy ended.<sup>13</sup>

## Statehood

Following statehood on January 26, 1837, the existing exemptions were adopted in the Revised Statutes of 1838. The quality and consistency of legislation in this field improved.

According to Justice Potter (writing in 1935), Michigan's debtor-creditor law was influenced by the state of the economy:

[With the Panic of 1837] 'The fancy values of landed property melted like snow in the April sun...one manufactory after another stopped, and the number of those who could find neither bread nor work increased by thousands and tens of thousands.'

The panic of 1837...bore particularly hard upon the people of Michigan.... To extricate themselves from their situation, the Legislature in 1842 passed...the first exemption law relating to personal property in this State worthy of the name.<sup>14</sup>

Indeed, in 1842, personal property exemptions were again expanded, and the value limits were increased several fold.<sup>15</sup> But when the numerous versions of the personal property exemptions from the late territorial era are considered, it is evident that the 1842 statute included little new material. Given that much of the development of Michigan exemption law took place in the late 1820s and early 1830s, which were a time of national prosperity and of rapid growth in Michigan,<sup>16</sup> the connection, perceived by Justice Potter during the Great Depression, between hard times and exemption laws, is vague.

In 1846, with the adoption of new Revised Statutes, the cumbersome 1842 list of exemptions was reorganized and simplified. The list is repeated here because it is recognizable in our current non-bankruptcy statute.

1. All spinning-wheels, weaving-loom with the apparatus, and stoves put up and kept for use in any dwelling-house;
2. A seat, pew, or slip, occupied by such person or family, in any house or place of public worship;
3. All cemeteries, tombs, and rights of burial, while in use as repositories of the dead;
4. All arms and accoutrements required by law to be kept by any person; all wearing apparel of every person or family;
5. The library and school books of every individual and family, not exceeding one hundred and fifty dollars, and all family pictures;
6. To each householder, ten sheep, with their fleeces; and the yarn or cloth manufactured from the same; two cows, five swine, and provisions and fuel for comfortable subsistence of such householder or family for six months;
7. To each householder, all household goods, furniture, and utensils, not exceeding in value two hundred and fifty dollars;
8. The tools, implements, materials, stock, apparatus, team, vehicle, horses, harness, or other things, to enable any per-

son to carry on the profession, trade, occupation, or business in which he is wholly or principally engaged, not exceeding in value two hundred and fifty dollars;

9. A sufficient quantity of hay, grain, feed and roots for properly keeping for six months the animals in the several subdivisions of this section exempted from execution, and any chattel mortgage, bill of sale, or other lien created on any part of property above described, except such as is mentioned in the eight subdivision of this section, shall be void, unless such mortgage, bill of sale or lien be signed by the wife of the party making such mortgage or lien, (if he have one).

In 1848, the first homestead exemption was enacted. Before its enactment, a judgment debtor was afforded a one-year redemption period following an execution against a homestead, and the property would not be sold on execution if the rent or profits could pay the judgment within seven years.<sup>18</sup> The 1848 law provided for a homestead of up to 40 acres or, if located in a city or village, one lot.<sup>19</sup> There was no dollar-value limit to the exemption.

With the adoption of the Constitution of 1850, exemptions were given an elevated legal status by being constitutionally guaranteed. Personal property was to be exempt in an amount not less than \$500. The 1850 Constitution modified the homestead exemption by limiting it to \$1,500 in value.<sup>20</sup>

During the remainder of the nineteenth century, despite several financial recessions and panics, the exemption laws received little legislative attention. An exemption for a sewing machine was added in 1861.<sup>21</sup> An exemption for shares in a building and loan association was added in 1887.<sup>22</sup> Other changes during this period of time were technical.<sup>23</sup>

## The Twentieth Century

During the first eighty years of the twentieth century, Michigan exemption law changed in small increments. The Constitution of 1908 retained a separate article concerning exemptions.<sup>24</sup> It kept in place the same minimum for personal property and raised the homestead exemption to \$2,500. Minor changes to the exemption law were enacted in 1929 (raising dollar amounts)<sup>25</sup> and 1939 (adding disability benefits).<sup>26</sup> Procedural changes regarding the homestead exemption were

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made in 1945.<sup>27</sup> In 1961, dollar amounts were raised, other minor changes were made, and the list was codified at MCL 600.6023.<sup>28</sup> The Constitution of 1963<sup>29</sup> raised the homestead to a minimum of \$3,500 and personal property to a minimum of \$750. MCL 600.6023 was amended accordingly to raise the homestead amount.<sup>30</sup>

The most significant twentieth century additions to the exemption statute were enacted in the 1980s. In 1984, MCL 600.6023 was amended to add an exemption for an IRA.<sup>31</sup> Funds held in 401(k) and other accounts “qualified” under the Internal Revenue Code and were added in 1989.<sup>32</sup> These additions resulted from the growth in tax-favored defined-contribution retirement savings plans.

Although the exemption statute changed in small steps over the last century, that period of time was an era of great growth in statutory law. Exemption law made its own contribution to this growth: statutes separate from the general exemption statute were added to allow exemptions for insurance policies, public-employee pensions, and welfare and veterans’ benefits.<sup>33</sup> A separate scheme for exemptions is contained in the State Correctional Facility Reimbursement Act.<sup>34</sup> Thus, many of the twentieth century additions to exemption law are not contained in the general exemption statute.

### A Brief History of Bankruptcy Exemptions

The first two federal bankruptcy acts specified their own exemptions. Those exemptions were less comprehensive than the contemporary Michigan exemptions. The Bankruptcy Act of 1800 allowed for only “his or her necessary wearing apparel, and the necessary wearing apparel of the wife and children, and necessary beds and bedding of such bankrupt.”<sup>35</sup> The Act of 1800 remained in effect until December 1803. The next bankruptcy law was in effect from 1841 to 1843, and it provided exemptions that were slightly more generous.<sup>36</sup>

The Bankruptcy Act of 1867 provided exemptions that included the types of necessities that had been exempt under the 1841 Act, but it also allowed property to be exempt under state law.<sup>37</sup> The 1867 Act remained in effect until 1878.

The next bankruptcy law was the Bankruptcy Act of 1898. The 1898 Act did not provide federal exemptions, but rather incorpo-

rated exemptions allowed by state law as of the date of the petition.<sup>38</sup>

The long run of the 1898 Act ended in 1978 with the adoption of the current Bankruptcy Code.<sup>39</sup> The Bankruptcy Code allows each debtor (or married couple) a choice of either (i) the exemptions available under state and federal nonbankruptcy law, or (ii) the exemptions specified in the Bankruptcy Code.<sup>40</sup> Each state, however, is permitted to “opt out” of the federal exemptions and restrict its residents to exemptions allowed under state law.

Michigan has not opted out of the federal exemptions, so Michigan residents have a choice between the “state” and “federal” exemptions.<sup>41</sup> Currently, the federal exemptions are more generous for most debtors, but the relative advantages of each set of exemptions vary between debtors and have varied over time with changes to each set of exemptions. With bankruptcy exemptions now provided for under the Bankruptcy Code, exemptions provided in Michigan law are invoked in fewer cases. They are nevertheless important for Michigan bankruptcy debtors who choose the state exemptions, such as a married debtor without joint debt and with substantial assets held in tenancy by the entirety. They also apply to debtors who are not eligible for bankruptcy relief or who choose not to seek it.

### Michigan’s Bankruptcy-Specific Exemption Statute

The latest change to Michigan exemptions resulted in the adoption of the bankruptcy-specific exemptions codified in MCL 600.5451. The process from which the bankruptcy-specific exemptions resulted was described recently by Judge James Gregg:

In 2001, an Advisory Committee to the Civil Law and Judiciary Subcommittee of the House Civil and Judiciary Committee of the Michigan Legislature (“Advisory Committee”) was formed to review and, if appropriate, provide recommendations to update the property exemption laws. The Advisory Committee labored for two years before issuing a Report and Recommendations to the Subcommittee (“Report and Recommendations”). The Report and Recommendations suggested many changes to the *general* Michigan exemption statute, § 600.6023,

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including an increase in the \$3,500 Michigan homestead exemption to \$30,000 (\$45,000 if the debtor or a dependent of the debtor was over 65 or disabled). The Report and Recommendations did *not* recommend limitation of these new exemptions only to bankruptcy proceedings. *Report and Recommendations of the Advisory Committee Regarding Proposed Modifications to the Michigan Exemption Statutes, the Purpose and Policy of Michigan Exemption Laws* (August 11, 2003).

With few changes, the new exemptions suggested by the Report and Recommendations were adopted by the Michigan Legislature in 2004, to be effective on January 3, 2005, as § 600.5451. However, the Legislature limited the application of the law only to proceedings involving “[a] debtor in bankruptcy under the Bankruptcy Code.” Applying the new statutory exemptions only to federal bankruptcy proceedings was without explanation in either the legislative history or the Advisory Committee records. [Citation omitted].<sup>42</sup>

One explanation for the adoption of the bankruptcy-specific provision is that it represented a compromise between the proponents and opponents of liberalized exemptions. The opponents, taking into consideration the interests of creditors, collection attorneys, and court officers, resisted change to the general exemptions, but they were less concerned with exemptions in bankruptcy. The proponents may have felt that modernization of the bankruptcy exemptions was the priority. As is further explored below, it is also possible to question the role of non-bankruptcy exemptions in the current system of debtor-creditor law.

### Defects in Michigan’s Exemption Law

Judge Gregg, in *In re Pontius* (quoted above), found MCL 600.5451 to be unconstitutional. Two other bankruptcy judges have also reached this conclusion.<sup>43</sup> Judge Dales, also of the bankruptcy court for the Western District of Michigan, more recently upheld the statute against a constitutional challenge.<sup>44</sup> Some other states’ bankruptcy-specific exemptions have been upheld,<sup>45</sup> so the constitutional issues can be debated. Nevertheless, the existence of these issues undermines reliance on

MCL 600.5451. This presents several problems. First, any debtor who plans his or her affairs in reliance on the bankruptcy-specific exemptions, or who invokes them in a bankruptcy case, may be surprised, and his or her counsel embarrassed, when the bankruptcy court disallows the exemptions. Second, the state exemptions are important for certain bankruptcy debtors, in particular married persons hoping to use the tenancy-by-the-entirety exemption.

The other arguable defect in Michigan’s exemption law is the failure of the general (non-bankruptcy) exemptions to keep up with inflation and with changes in property ownership. As discussed in *Pontius*, the 2003 legislative advisory committee acknowledged the need to update the exemptions. But the bankruptcy-specific statute absorbed the impetus to improvement and left the general provision neglected. The dollar-amount exemptions (such as \$1,000 in furnishings and a \$3,500 homestead) are smaller in relative value than ever before. There is no exemption for medically-prescribed devices, or for an automobile other than as a “tool of the trade.” Further, there have been vast changes to the types and amounts of property required for a debtor and his or her household to live productively and self-sufficiently. Michigan’s non-bankruptcy homestead exemption, which was one of the first if not the first in the nation, at \$3,500, is the now the lowest among those states with a homestead exemption. (The median homestead exemption under state law is approximately \$50,000. Maryland, Delaware, Pennsylvania and New Jersey have no non-bankruptcy homestead exemption).

If the bankruptcy-specific statute is eventually upheld by the Sixth Circuit or the United States Supreme Court, the remaining question will be whether the non-bankruptcy exemptions require updating. The usefulness of exemptions outside of bankruptcy is debatable. In the nineteenth century, bankruptcy relief was not widely available. The federal bankruptcy statutes were in effect for only about 20 years in that century, and the first bankruptcy act was applicable only to merchants and traders.<sup>46</sup> The centrality of state exemptions continued with the first “permanent” bankruptcy law, the 1898 bankruptcy act, which relied on state exemptions.<sup>47</sup> In 1979, when the current Bankruptcy Code became effective, federal exemptions became an option for the first time since

1843.<sup>48</sup> Bankruptcy relief is now widely available, although somewhat restricted following the 2005 amendments that added the means test.<sup>49</sup> With the prevalence of bankruptcy as an option for persons with unmanageable debt and the availability to Michigan residents of the federal bankruptcy exemptions, state-law exemptions have diminished in importance. They are nevertheless useful, for example, to an elderly person whose only income is social security (exempt under federal law) and who otherwise would not need to file bankruptcy. The arguments against more liberal non-bankruptcy exemptions include the argument that it is not bad policy to force a debtor seeking relief into bankruptcy since bankruptcy is a comprehensive remedy with both relief for debtors and protections for creditors.

### Options Available

The Business Law Section of the State Bar, through its Debtor/Creditor Rights Committee, has addressed the constitutional and reform issues. The following options for a resolution of the crisis caused by the rulings invalidating the bankruptcy-specific statute have been identified:

1. Obtain a ruling from the court of appeals upholding *Jones/Schafer* and overruling *Pontius and Wallace* and retain the current statutes basically as they are today. Judges Gregg and Hughes may have correctly decided the constitutional issue, in which case, the second option would deserve more serious consideration.
2. Merge MCL 600.5451 and 600.6023, raising the general exemptions to the levels currently only available in bankruptcy. This would resolve the constitutional issue presented by the bankruptcy-specific statute. Language for such a proposal has been prepared by the Debtor/Creditors Rights Committee of the Business Law Section of the State Bar, but the proposal has not yet resulted in legislation.

### Conclusion

At present, to rely on the bankruptcy-specific state exemptions is to skate on thin ice. Any bankruptcy debtor who chooses the state exemptions should be advised to be prepared to rely on other exemptions if challenged. A liberalization of the general state exemptions should be considered, but opposition by creditor groups should be expected.

### NOTES

1. An act for the relief of poor prisoners who are committed by execution for debt, §4, Laws of the Territory of Michigan (Lansing: WS George & Co, 1871-84), (hereafter LTM), vol 1, p 83, 87 (Oct 4, 1805).
2. An additional act concerning district courts, §12, LTM, vol 2, p 7, 9 (April 2, 1807).
3. An act concerning executions, §2, LTM, vol 4, p 57, 58 (Feb 18, 1809).
4. An act to abolish the courts of districts, and to define and regulate the powers, duties and jurisdiction of justices in matters civil and criminal, § 7, LTM, vol 4, p 98, 99 (Sept 16, 1810).
5. *Id.* See also An act to regulate and define the duties and powers of Justices of the Peace and Constables, in civil cases, §30, LTM, vol 1, p 604, 620 (May 20, 1820).
6. An act concerning the Militia of the Territory of Michigan, § 1, LTM, vol 2, p 47 (Feb 10 1809); An act to provide for organizing and disciplining the Militia, § 1, Laws of the Territory of Michigan (Detroit: Sheldon & Reed, 1820), (hereafter LTM 1820), p 177 (April 20, 1820).
7. An act subjecting Real Estate to the payment of debts, and concerning Executions, LTM, vol 1, p 860 (April 5, 1821), LTM 1820 p 429.
8. *Id.*, §20.
9. An act to amend an act entitled "An act subjecting real estate to the payment of debts, and concerning executions", LTM, vol 2, p 234 (March 30, 1825).
10. An act concerning Judgments and Executions, § 25, LTM, vol 2, p 487, 492 (April 12, 1827).
11. An act for the relief of insolvent debtors, §16, LTM, vol 2, p 396, 403 (April 12, 1827).
12. An act to amend an act entitled "An act concerning Judgments and Executions", LTM, vol 2, p 703 (July 3, 1828).
13. An act to amend an act entitled "An act concerning Judgments and Executions", § 2, LTM, vol 3, p 1073 (April 20, 1833).
14. *Kleinert v Lefkowitz*, 271 Mich 79, 83, 259 NW 871, 872 (1935).
15. 1842 PA 48, repealed by Revised Statutes 1846, title 33, ch 173, § 1.
16. Finkelman, Paul and Hershock, Martin, eds, *The History of Michigan Law* (Athens: Ohio U Press 2006), ch 2, p 38.
17. Revised Statutes 1846, title 22, ch 106, § 27.
18. An act subjecting Real Estate to the payment of debts, LTM, vol 2, p 42 (Feb 4 1809); An act subjecting Real Estate to the payment of debts, and concerning Executions, § 4, LTM, vol 1, p 860 (April 5, 1821), LTM 1820, p 429.
19. 1848 PA 109, Compiled Laws 1871, ch 198, §6137.
20. Const 1850, art 16.
21. 1861 PA 143, Compiled Laws 1871, ch 198, §6132.
22. 1887 PA 50, § 16.
23. See 1849 PA 185; 1863 PA 156; 1893 PA 43.
24. Const 1908, art 11.
25. 1929 PA 87.
26. 1939 PA 225.
27. 1945 PA 14.
28. 1961 PA 236, Ch 60, § 6023, eff Jan 1, 1963.
29. Const 1963, art 10, §3.
30. 1963 PA 40.
31. 1984 PA 83, MCL 600.6023(1)(k).
32. 1989 PA 5, MCL 600.6023(1).
33. Other exemptions are listed in section 3 of the proposal.

34. 1935 PA 253; 1984 PA 282, MCL 800.401 et seq.
35. Bankruptcy Act of 1800, § 5, 2 Stat 19
36. Bankruptcy Act of 1841, § 3, 5 Stat 440.
37. West Bankruptcy Exemption Manual, § 1.01(c); 14 Stat 517.
38. West Bankruptcy Exemption Manual, § 1.01(d); 30 Stat 544.
39. 11 USC 101 et seq., eff October 1, 1979.
40. 11 USC 522(b).
41. MCL 600.5451.
42. *In re Pontius, Opinion Regarding Constitutionality of Michigan Bankruptcy Specific Exemptions*, 08-04124 (Bankr WD Mich, Dec 22, 2009), at 3-4. Available at [miwb.uscourts.gov/opinions](http://miwb.uscourts.gov/opinions).
43. *In re Wallace*, 347 BR 626 (Bankr WD Mich 2006), and *In re Vinson*, 337 BR 147 (Bankr ED Mich 2006), *rev'd* 347 BR 620 (ED Mich 2006).
44. *In re Dorothy Ann Jones* and *In re Steven M. Schafer, Opinion and Order Regarding Constitutionality of Exemption Statute*, 09-09415 and 09-03268 (Bankr WD Mich, April 22, 2010). Those cases are on appeal.
45. See e.g. *In re Peveich*, 574 F3d 248 (4<sup>th</sup> Cir. 2009).
46. Bankruptcy Act of 1800, § 1, 2 Stat 19.
47. Bankruptcy Act of 1898, § 6, 30 Stat 544.
48. 11 USC 522.
49. 11 USC 707.



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