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Collection of Judgments - The New Exemptions Law

Joan G. Brannon

Ch. 490, S.L. 1981 allows North Carolina residents to claim a substantially greater amount of their property to be exempt from seizure and sale to pay off judgments against them than they formerly held. Ch. 490 originally took effect October 1, 1981, but was postponed until January 1, 1982, by Ch. 1001, S.L. 1981. This memorandum will discuss that legislation. The last section of the memorandum is specifically written for sheriffs to discuss their role under this new law.

Before discussing the new bill some discussion of how it came about and of the former law on exemptions is necessary. Ch. 490 was originally part of a larger bill rewriting all of the laws relating to the collection of money judgments. The basic change that larger bill would have made was to provide that the court would be responsible for the enforcement of money judgments. It would have provided that after a judgment was rendered, the judgment was rendered, the creditor would bring a collection proceeding before a judge. The judge would determine how that judgment would be collected and what liens would be placed on specific property to secure the judgment as well as what property was exempt. This larger bill would also have revised substantially tenancy by entirety law with regard to its effect on judgments and would have provided for limited garnishment of wages. Ch. 490 was the only part of the original larger bill that was enacted. Thus, the old law providing for the sheriff to collect judgments by executions remains unchanged, but the new law provides that the setting aside of exempt property is to be done by the court rather than the sheriff. Because H 490 was originally intended to be a part of a larger package, its

provisions do not always make sense without the other part of the package and do not always mesh with the law on executions.

CONSTITUTIONAL EXEMPTIONS

Article X, Sections 1 and 2 of the North Carolina Constitution provide that every resident of North Carolina is entitled to personal property to a value fixed by the General Assembly but not less than $500 and a homestead to a value fixed by the General Assembly but not less than $1,000 to be exempt from execution issued for the collection of any debt. The General Assembly enacted G.S. 1-369 to -392 to implement these constitutional provisions. That law provides that every resident was entitled to an exemption of $1,000 in real property owned and occupied by him and $500 in personal property. The statute requires the homestead exemption to actually be set off in land and requires the sheriff to set off the exemption before levying on the real property. The sheriff summons three appraisers who go out to the land and draw off an area with a fair market value of $1,000, describing that area by metes and bounds. The homestead is set off without regard to any mortgages on the property (Miller v. Little, 212 N.C. 612 (1937)). The sheriff then sells the remainder of the tract at an execution sale. (Generally, no one buys at such a sale because the sheriff is selling all of a house except for one portion--for example, the front hall. The debtor would continue to own the front hall, and the purchaser at the sheriff's sale would own the rest of the house, not a very desirable arrangement for most people.) The debtor is also entitled to $500 of his personal property to be exempt from sale under execution. The debtor has to ask for that exemption before the sheriff will set it aside. If the debtor asks for his exemptions, the sheriff summons three appraisers who set off $500 of his personal property. The debtor may choose whatever property he wishes to have set aside. The appraisers value the property without regard to any liens.

NEW EXEMPTIONS

The new law grants more liberal exemptions than those specified in the North Carolina Constitution. It continues the requirement that to be entitled to any exemptions, the debtor must be a resident of North Carolina, and he must be a natural person and not a corporation. It sets out eight exemptions:

(1) The debtor may exempt his aggregate interest not to exceed $7,500 in value, in real or personal property that he or his dependent uses as a residence or in a burial plot for the debtor. Several differences are found between this exemption and the $1,000 homestead exemption. First, the definition of value in Ch. 490 differs substantially from the former law. As mentioned, the homestead exemption was assigned without regard to any liens on the property. But G.S. 1C-1601(b) defines value as the "fair market value of an individual's interest in property, exclusive of valid liens." In other words, under the new law the debtor's equity interest in property is his value in the property. Although the statute does not specify the time at which the valuation is to be set, logically it should be the fair market value at the time of the hearing to set aside the exemption since that is the time at which some action regarding the property will take place. Another problem in assigning this exemption arises when the debtor's interest is greater than his allowable exemption. Is the residence exemption assigned out of the land itself or is the land sold and the debtor given his exemption out of the proceeds of the sale. As mentioned, under the homestead exemption the debtor was entitled to have a portion of his property valued at $1,000 set apart and not sold under an execution. The procedure to be followed under the new exemption law is different. Under this statute if the debtor's interest exceeds $7,500, the judicial official setting aside the exemption can order the property sold with the first $7,500 going to the debtor and the excess to the creditor under the execution. Under the homestead law, the statutory provisions provided that the appraisers lay off to the owner such portion of his land as he selects to be described by metes and bounds (G.S. 1-372). Thus, the statutory procedure implementing the constitutional provisions clearly provided for the property itself to be set aside. Whereas, under the new law G.S. 1C-1603(e)(6) provides for the court to order the sale of property having excess value. Also, since these exemptions are patterned after the federal bankruptcy act, one can look to that act to see how the exemption is handled. Under that act, in the situation mentioned, property is sold and the excess given to the trustee for the estate.

This exemption provides that the debtor may take his exemption in property that he or his dependent uses as a residence. The statutory language is identical to the language in the federal bankruptcy act. However, the federal law defines dependent to include spouse whether or not the spouse is actually dependent. The North Carolina statute does not define dependent so that the court will have to

determine what dependent means for purposes of his statute. If a dependent is defined as someone receiving more than fifty percent of his support from the debtor or one substantially dependent on the judgment debtor for support, a residence might not be exempt under state law where it would have been under the federal law. For example, assume that a debtor is owner of a mobile home or real property; the debtor and his wife are separated; and the property is used by the wife as her residence. Under the federal bankruptcy law, the debtor could claim his $7,500 residence exemption in that property without any showing of his spouse's dependency on him. Under Ch. 490 the debtor will only be allowed to claim that property if he can prove that his spouse is his dependent.

Perhaps the most important point to remember about granting a debtor an exemption in his residence is that H 490 makes no change in tenancy by entirety law. Therefore, tenancy by entirety property held by a judgment debtor cannot be reached by a judgment creditor unless his judgment is against both husband and wife. The law remains that a creditor cannot reach a residence owned by husband and wife when the judgment is against the husband only or is against the wife only. The residence exemption applies to real or personal property used as a residence. The 1981 General Assembly enacted a new G.S. 45-2.5 providing that on and after the September 1, 1981, when husband and wife become co-owners of a mobile home, they become tenants by the entirety unless they specifically provide otherwise. Thus, mobile homes purchased after September 1, 1981, will be treated the same as real property residences. If the judgment is against both husband and wife, the residence is subject to the judgment and the spouses can claim their statutory exemption in the property. Another question arises: When both husband and wife are judgment debtors is each spouse entitled to claim a $7,500 equity interest, for a total of $15,000 exemption in the residence? Or as tenants by entirety are they only entitled to one exemption? Under the constitutional homestead law, the court mentioned the problem in dictum in one case and said that if it was called to rule on the matter it seemed that only one homestead should be laid off since that is all the survivor would get (Martin v. Lewis, 187 N.C. 473 (1924)). However, since the court never really reached the issue and the new law provides that each individual who is a debtor is entitled to his exemptions, the safest course under the new law would be to allow <u>each</u> spouse to claim a $7,500 equity interest in the residence.

Case law under the homestead exemption provides that if the debtor does not own a dwelling, he can claim his homestead exemption in vacant land; or if he owns a heavily

mortgaged dwelling and other property that is unencumbered, he canld claim his exemption in the nondwelling. However, under the new law it seems clear that the debtor is only entitled to his $7,500 exemption in real or personal property used as his residence. The law provides an alternative exemption in any property of the debtor's choosing if less than $2,500 of the residence or burial plot exemption is used. That exemption is discussed as (2) below.

(2) The law grants to a debtor his aggregate interest in any property of his choosing not to exceed $2,500 in value less any amount of the exemption used under the residence or burial plot exemption discussed above. This exemption is an alternative to exemption (1) and may be used as follows: If a debtor rents his residence and does not have a burial plot he wishes to claim, he may claim $2,500 interest in any property not otherwise exempt. For example, if he owns a tract of land in which he has $1,500 equity and a diamond ring with a value of $1,000, he can claim both items under this exemption. This exemption can also be used when the debtor uses less than $2,500 under exemption (1). For example, if he had a residence in which his equity was only $1,500, the debtor could claim that residence under the first exemption, and then claim a ring with a value of $1,000 under this exemption. If the debtor claims $2,500 interest or more in his residence and burial plot, he may not claim anything under this second exemption.

If the judgment is against one spouse only and the residence is owned as tenants by entirety and therefore cannot be reached under this execution, presumably the debtor spouse could use the full $2,500 in property owned by him alone. This situation means that a married debtor may claim some property as exempt under a judgment against only him and other property when the judgment is against both spouses.

(3) The debtor is allowed to exempt his interest not to exceed $1,000 in value in one motor vehicle. If he has a 1981 Cadillac with a fair market value of $13,000 on which there is a $12,000 lien, he can exempt the car because he only has a $1,000 interest in the car. If he has no lien on the car, he can only exempt $1,000 and the court can order the car to be sold giving the first $1,000 to the debtor, and the remainder to be used to satisfy the execution. If the debtor owns two cars with an equity interest of $500 in each, he may only claim his interest in one of the cars. The other would be subject to sale to satisfy the execution.

(4) The law allows the debtor to claim an aggregate interest, not exceeding $2,500 in value for himself plus $500 for each of his dependents not to exceed $2,000 for dependents, in household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments that are held primarily for the personal, family, or household use of the debtor or his dependent. The debtor may select from his household belongings, apparel, etc. which items he wants to exempt. If the debtor has four dependents, he is entitled to have $4,500 of his household goods, etc. set off as exempt. To be claimed under this exemption, the goods must be used for personal or family use. For example, crops grown for personal use may be claimed, but a farmer who grows crops for his business may not claim the crops under this exemption. Likewise, a violin owned for personal use may be claimed, but if the debtor is a professional violinist, the violin may not be claimed under this exemption. Exemption (5), discussed below, is available for items used in a debtor's trade. One of the problems under this household goods exemption is how many exemptions does a family get when both the husband and wife are debtors. An example is a family of a husband and wife, with three kids; only the husband works; and his wife and children are his dependents. If both husband and wife are joint debtors, may the husband claim $4,500 interest (for himself and his wife and three kids) and wife as debtor claim her $2,500 interest? Or are husband and wife prevented from doubling up and claiming as both a debtor and a dependent of another debtor? If the latter is true, then may the wife choose whether to have her husband take $500 of his property for her as a dependent or to take $2,500 of her property as the debtor. The law does not answer the question; following it literally would allow the husband to take $500 for the wife as his dependent and the wife to take $2,500 for herself as the debtor. Logically that does not make sense, and the spouse should be put to an election of one. The problem may be complicated even more if both husband and wife work and both are debtors. May each claim the children as dependents? Again, the answer depends on the definition of dependent. If a person is dependent on another if he receives more than 50 per cent of his support from that person, only one of the parents may claim the exemption. However, if dependence means reliance on a person for support, both parents might be able to claim the children, which would make it possible for husband and wife as joint debtors to each claim $4,500 of their own property to be exempt from sale under execution. Again, it is probably best to make the debtors choose who claims the dependents and not let them double up.

(5) The debtor is entitled to claim his interest, not exceeding $500, in any tools of his trade or the trade of his dependent. Tools of the trade includes any implements or books used in the debtor's trade. For example, a farmer may claim a $500 interest in his farm equipment; a lawyer may claim $500 in his legal books; and a musician $500 in a musical instrument.

(6) Any life insurance the debtor has on his life is exempt if his spouse or children are the sole beneficiaries. This life insurance exemption is granted in Art. X, Sec. 5 of the North Carolina Constitution.

(7) Ch. 490 exempts any professionally prescribed health aids for the debtor or for his dependents. No value limit is placed on this exemption.

(8) Finally, the debtor may exempt all compensation received for personal injury or death of a person on whom the debtor was dependent, except from claims for funeral, legal, medical, dental, hospital, and health care charges related to the accident or injury giving rise to the compensation.

EXCEPTIONS TO THE LAW

The new law then sets out certain types of property and claims in which exemptions may not be asserted:

(1) The exemptions apply to individuals. If the judgment debtor is a corporation or partnership, no exemptions are applicable.

(2) The debtor must be a resident of North Carolina. No exemptions apply if he is not.

(3) Following a provision in the federal bankruptcy act, the $2,500 exemption in any property (exemption 2), the motor vehicle exemption (exemption 3), the household goods exemption (exemption 4) and the tools of the trade exemption (exemption 5) do not apply to tangible personal property purchased by the debtor less than 90 days before the judgment collection proceeding is begun. This provision will keep the debtor from being able to go out after judgment has been rendered against him and as execution is about to issue and convert nonexempt property into exempt personal property. For example, if a debtor did not own a car, but had $1,000 in a bank account that he could not exempt, he could not take the $1,000 to purchase a car within 90 days of the creditor's filing of a motion to set aside the exemptions and exempt the car. The car could be sold to satisfy the judgment. However, the law would not prevent the debtor from taking that $1,000 and converting it to exempt real property.

(4) Claims of the United States or its agencies are subject to the exemptions only if federal law provides.

(5) The exemptions are also inapplicable to claims of the state or any of its local governments for taxes or for appearance bonds. The inapplicability to claims for taxes is found in Article X, Sec. 2 of the North Carolina Constitution and carries forward the present law. The exclusion for appearance bonds is new. Under the present law a judgment debtor is authorized to claim his constitutional exemptions when the judgment against him is for forfeiture of an appearance bond, since the constitution does not exempt appearance bonds from coverage. This new law provides that the debtor may not claim the new broad statutory exemptions if the judgment is for forfeiture of an appearance bond. That leaves unanswered the question whether when the new law takes effect the judgment debtor may claim his constitutional exemptions ($1,000 homestead and $500 personal property) even though he is not allowed to claim statutory exemptions. In my opinion, he would be entitled to claim those exemptions since a statute cannot cut off a constitutional right. Thus, clerks and magistrates accepting appearance bonds should continue to assure themselves that the sureties have property over and above the $1,000 homestead exemption and $500 personal property exemption. Appearance bond forfeitures are the one kind of case in which the debtor will continue to claim the old exemption.

(6) The statute also disallows exemptions for claims of laborer's or mechanic's liens as to the specific property affected, which carries forward the present law as required by Art. X, Sec. 3 of the North Carolina Constitution.

(7) The exemptions do not apply to claims for the repair or improvement of the specific property affected.

(8) The exemptions do not apply to claims for statutory liens on the specific property affected, other than judicial liens. For example, if a creditor is seeking to enforce a storage lien under G.S. 44A-2(a) in household goods stored by him the debtor may not claim his household goods exemption in that property.

(9) The exemptions do not apply to claims for payment of obligations contracted for the purchase of the specific property affected or to a contractual security interests in the specific personal property affected, except that the exemptions may be claimed in a debtor's household goods notwithstanding any contract for a nonpossessory, nonpurchase money security interest in any such goods. The law in North Carolina has been that a debtor could not claim his exemptions in any property that the creditor was seeking to recover under a lien or security agreement. The exception in

the statute that if the security agreement is not a purchase money or possessory security interest and the security is household goods, the debtor may claim his exemption in those goods is new to North Carolina. Generally, this provision will apply when the finance company is the creditor, since they are the most likely lenders to have taken a nonpurchase money security interest in household goods. The main problem with this exemption is how it is applied under Ch. 490. Ch. 490 and the larger bill from which it was derived applied only to the collection of money judgments and did not deal at all with the collection of judgments for specific property. In fact, the original version did not contain the provision allowing the exemption for household goods security interests. The provisions of Ch. 490 would apply where a judgment creditor is awarded a money judgment and then seeks to enforce the money judgment by sale of the household goods that were security for the debt. However, what is not clear is how the statute applies to the situation where the judgment is to recover household goods, and the plaintiff seeks to enforce the judgment by having the clerk issue a writ of possession for personal property. The first question is whether the provision applies at all to the issuance of a writ of possession. G.S. 1C-1601(a), the section setting out the exemptions, provides that it allows the debtor to retain exempt property free of the enforcement of the claims of his creditors. As written, those exemptions would apply to any claims of the creditor, including actions for possession as well as for money judgments. If the conclusion is reached that the debtor is entitled to claim the exemption when faced with a writ to recover possession, one must ask if the clerk has a duty to have the debtor notified of his rights under the law. I think it can be argued that the clerk need not have any notice issued since G.S. 1C-1603(a)(4) requires the clerk to cause notice to be served in a proceeding for enforcement of a money judgment. A writ of possession arises out of a judgment for possession of property and not a money judgment. If the provision applies to writs of possession but the clerk is not responsible for seeing that notice of rights be issued to the debtor, then the exemption would only be granted if the debtor moves to have it set aside. If the debtor claims this exemption in secured household goods, the court will be faced with the issue of whether this exemption can apply retroactively to security agreements entered into before January 1, 1982. The question of retroactivity of an identical provision in the federal bankruptcy act has been litigated in several bankruptcy courts. Some courts have upheld its retroactivity and others have held that the provision cannot be imposed retroactively without violating the due process clause of the Fifth Amendment of the U.S. Constitution. Another legal basis exists for Ch. 490 not

being applied retroactively. Article II, Sec. 10(1) of the United States Constitution prohibits a State from passing any law impairing the obligations of contracts. In my opinion, a state law voiding a security agreement entered into before the state law was passed would be an impairment of a contract. The same argument may be made for all debts arising before January 1, but when the contract is for an unsecured debt it is less likely that the provision will fall for impairment of contract since the contract itself does not provide for specific property to be used to satisfy the debt.

(10) Finally, claims for alimony or child support are not subject to any exemptions. This statutory exception carries forward the current law with regard to the constitutional exemptions (Wright v. Wright, 216 N.C. 693, 697 (1939); Walker v. Walker, 204 N.C. 210 (1933)).

CLAIMING CONSTITUTIONAL EXEMPTIONS

G.S. 1C-1602 provides that a debtor may elect to take the personal property and homestead exemptions set out in the North Carolina Constitution rather than these statutory exemptions. However, Ch. 490 repeals the statutory provisions for setting aside those exemptions. Presumably, the court will set the constitutional exemptions aside if the debtor claims them. Under the case law the debtor is entitled to his constitutional homestead exemption as a matter of right, and the sheriff had to lay if off even if the debtor did not request it. However, the sheriff only set aside the personal property exemption if the debtor claimed it. Since the new law puts the debtor to an election between the statutory and constitutional exemptions, the debtor may be required to request his constitutional exemptions before the court is required to give them to him. It is very unlikely that a debtor will select his constitutional homestead exemption over the statutory exemption, since it is substantially less in value. If he chooses his constitutional exemption, the main question will be whether he is entitled to have it laid off in land. (In fact, that would be the only reason why a debtor might choose the constitutional exemption over the statutory exemption. If his equity in his residence is worth more than $7,500, and the homestead is set off by laying off a portion of the property worth $1,000 rather than selling the property, he may figure that no one will buy at the sale and he can keep the entire house, if he has the front hall set off, rather than having it sold and giving him the first $7,500.) It is possible to argue that the constitution does not require the exemption to be laid off in land; rather it is the statute implementing the constitution--G.S.

1-371--that requires it to be set off in that manner. Since G.S. 1-371 is repealed by Ch. 490, the homestead need not be in land. The court could, however, find that the constitution would require it to be set off in land. The safest course for the court to follow might be to allow the debtor to claim the constitutional exemption in land and have the homestead set off in metes and bounds.

The debtor may not split his exemptions between the constitutional exemptions and the statutory exemptions. He must make an election. If he takes the constitutional exemptions, he takes both the $1,000 homestead exemption and the $500 personal property exemption. If he takes one of the statutory exemptions, he takes them all.

As mentioned earlier, the one instance in which a debtor will claim his constitutional exemptions is when the judgment is for forfeiture of an appearance bond. Since he is not entitled to the statutory exemptions, the debtor will want the constitutional exemptions.

PROCEEDING TO SET ASIDE EXEMPTIONS

Ch. 490 specifies that either the district court judge or the clerk of superior court may set aside exempt property. It is unclear when the judge will be hearing the matter and when the clerk will set aside exemptions. The clerks and judges of each judicial district will have to decide on some division.

Debtor Initiates Proceeding

G.S. 1C-1603(a) authorizes either a judgment debtor or judgment creditor to begin proceedings to designate exemptions. The debtor may have his exempt property designated in a separate action before the district court judge or clerk. This procedure, allowing the setting aside of exemptions while no lawsuit is pending, patterns the old law found G.S. 1-386 through -389. Probably it will rarely be used. The Administrative Office of the Courts has determined that it will be classified as a civil action. If such an action is brought, it should be filed in the county in which the debtor resides and should probably be calendared before the district court judge, and district court fees collected.

G.S. 1C-1603(d)(2) provides that if the debtor initiates the proceeding to set aside exemptions, notice of the hearing must be given to each creditor scheduled by the debtor.

Therefore, if the debtor lists any creditors, he must give them notice under Rule 5 of the Rules of Civil Procedure. The statute does not set out what to do if no creditors are listed. Under the old law, the debtor is required to publish notice of his intent to set aside a homestead in a local newspaper once a week for six weeks. Although there is no provision in the new law, the court may require the debtor to publish a notice of the proceeding.

G.S. 1C-1603 also allows the judgment debtor to have the exemptions set aside in a pending case, except a case before a magistrate. Thus, the debtor who wants to have his exemptions set aside while he is being sued would file a motion in the cause and a schedule of his property. The clerk would set a hearing date and the debtor must serve the notice of the hearing on each creditor scheduled under Rule 5 of the Rules of Civil Procedure. Although either the district court judge or clerk is authorized to hear the matter, if the case is being tried in the district court, the district court judge might be the appropriate one to hear it. If the case is being tried in superior court, the clerk probably should hold the hearing to set off the exemptions.

G.S. 1C-1603 also authorizes the debtor to set off his exemptions in a proceeding relating to the enforcement of a money judgment. Thus, when execution is issued or a supplemental proceeding is begun the debtor may file a motion in the cause to set aside his exemptions. The motion will be filed in the county in which the judgment was rendered since that is where the execution will issue. Service of the motion and notice of hearing would be made by the debtor under Rule 5 of the Rules of Civil Procedure.

Creditor Initiates Proceeding

Debtors will infrequently move to set aside their exemptions. More often the creditor will be the moving party since he will want to enforce his judgment. The law authorizes the judgment creditor to have exempt property designated in a proceeding to enforce a money judgment. The Administrative Office of the Courts has redrawn the execution and developed a procedure by which the judgment creditor may have the clerk issue a first execution ordering the sheriff to satisfy the judgment out of the debtor's funds. Essentially, this execution will require the sheriff to go to the debtor and demand payment. If the debtor pays, the sheriff will return the execution and money collected (minus his commission) to the clerk. If the debtor refuses payment, the sheriff will return execution stating that payment was refused. At this point Ch. 490 would come into play. The

clerk would require the creditor to move to set aside the exemptions if he wishes to proceed to have any of the debtor's property seized and sold to satisfy his judgment.

G.S. 1C-1603(a)(4) provides that if it appears in a proceeding for enforcement of a money judgment (including an execution or a supplemental proceeding) that exempt property may be affected and there has been no allocation of exempt property, the court must cause notice to be served upon the judgment debtor advising him of his rights. The statute then sets out the form that the notice must take. Under the procedure recommended by the Administrative Office of the Courts the clerk would have the notice issued when the creditor moves to set aside the exemption after the demand for payment has been refused. That recommendation is based on an interpretation that it cannot appear to the clerk that exempt property may be affected until the sheriff is ordered to seize property. Therefore the clerk may issue an order to the sheriff to go out and ask for payment without first serving the notice of debtor's rights on the debtor. Another possible interpretation of the statute is that the sheriff's request for payment is a proceeding to enforce the judgment. Exempt property may be affected and has not yet been set off so the clerk must cause the notice to be served when he issues the order to the sheriff to demand payment. The issue will have to be settled by the court or legislature, but until it is settled the procedure recommended by the AOC is the more practical of the two possibilities. Another equally troubling interpretative problem with the language of the requirement to give notice is that it requires the court to "cause notice to be served upon the judgment debtor advising him of his rights." G.S. 1C-1603(d) requires that notice to be served under Rule 4 of the Rules of Civil Procedure. It is not clear whether the court may "cause the notice to be served" by requiring the creditor to pay the costs to have it served under Rule 4 or whether since it is a notice from the court, the court must make sure it is served and bear the costs of having it served. It certainly seems that the clerk can require the creditor to advance the costs of service, taking the position that it is like any other civil matter where the moving party is responsible for advancing costs. The clerk will have the creditor serve a copy of his motion to set aside the exemption and the schedule of property to be filled in by the debtor along with the notice of rights and hearing. The statute provides that the debtor must be given at least twenty days from receiving notice of his rights to return the schedule. Under the procedure recommended by the AOC, the court would then hold a hearing to set aside the exemptions and once exemptions were set aside, the creditor could have an execution issued ordering the sheriff to satisfy the judgment out of any nonexempt property.

In some instances a judgment creditor may move to have the exemptions set aside before an execution demanding payment is issued. In that situation, the clerk should set the date for the hearing, and cause the notice of rights to be served on the debtor. The hearing would be held and exemptions set off. No execution demanding payment from defendant's funds would ever be issued. After the exemptions were set off, the clerk would issue an execution commanding the sheriff to seize and sell sufficient property to satisfy the judgment.

Hearing

G.S. 1C-1603(e) provides that the court must hold a hearing to determine the exempt property. At many hearings, the first question that will have to be resolved is whether the debtor has waived his right to exemptions. G.S. 1C-1601(c) allows the debtor to waive the exemptions by transferring property allocated as exempt, by written waiver, or by failure to file the schedule. Waiver by transferring property allocated as exempt would only arise in a hearing to modify an exemption order. Written waivers will probably be rare also. To be valid the waiver must be agr d to after judgment has been entered and must be approved by the court. The court must find that the debtor made the waiver freely, voluntarily, and with full knowledge of his rights to exemptions and knowledge that he was not required to make the waiver. The law also provides that the court may not permit a waiver to the extent the exemptions are necessary to ensure the reasonable support needs of the judgment debtor's dependents. Therefore, some finding must be made on that regard before a written waiver may be approved. The waiver issue that will arise frequently is waiver by failure to assert the exemption after notice to do so. The statute was written on the assumption that most debtors would exercise their rights and fill out the schedule. In all likelihood the probable reaction of most debtor's when they are served with a six-page form to complete will be to throw it in the trash can. The debtor will not appear at the hearing. The clerk or judge then must decide whether he has waived his right to exemptions. The statute requires the court to find that the debtor was properly served with notice and had a reasonable opportunity to assert his exemption before holding that a waiver occurred. If that were all that statute said, the matter could probably be resolved fairly simply. Most hearings would end in a finding of waiver, and execution against all the debtor's property would issue. The problem is that, as mentioned above, the statute also provides that the court may not permit waiver of exemptions to the extent the exemptions are necessary to ensure the reasonable support needs of the judgment debtor's dependents. (That provision was in the bill because the larger package allowed wage gar-

nishment above a certain wage exemption. Waiver of the wage exemption would not be allowed when those wages were necessary to support debtor's dependents.) When the debtor does not appear at the hearing and has not filled out the schedule, would it be proper for the court to find a waiver without the debtor's having replied. May the court find a waiver unless the debtor comes forward and makes some showing of necessity for support of his dependents, thereby putting the burden on the defendant to show need of the exemptions by his dependents. If this reasoning were followed, the court would make a finding that no evidence was presented that the defendant needs the exemptions for the support of his dependents. Or must the court not permit a waiver unless it has evidence to allow it to make a finding that the exemption is not needed for dependent's support. If the latter is required, the debtor must be brought before the court before any waiver can be allowed. If the matter is going to be heard by a clerk, two possible procedures that could be followed to bring the debtor before the clerk are: (1) Issue the initial execution to demand payment. When that is returned because payment is refused, if the creditor wishes to proceed, require him to file a supplemental proceeding under G.S. 1-352. The notice of supplemental proceeding would be served on the debtor requiring him to appear before the clerk. If the debtor did not appear after being ordered to do so, the clerk could exercise his contempt powers. When the debtor appears for the hearing, the clerk could give him a copy of the schedule. It would probably be necessary to continue the hearing to another date to give the debtor time to fill out the schedule. At the initial supplemental proceeding hearing, the clerk could also make some finding of whether the debtor has any dependents who would need the exemptions for their support. If the debtor does not return the schedule, the clerk would then be able to find a waiver of exemptions for failure to assert exemptions or could use his contempt powers to make the debtor fill out the schedule. (2) Issue the initial execution to demand payment. When payment is refused if the creditor wishes to proceed, set a date for the hearing, require the creditor to have the debtor served with a notice of his rights, a schedule of his property and notice of the hearing. If the debtor does not submit a schedule or appear at the hearing, the clerk could require the creditor to begin a supplemental proceeding. If the debtor did not appear when ordered, the clerk could exercise his contempt powers. When the debtor did appear, the clerk could make a finding of whether the exemptions were needed for the support of the debtor's dependents.

If a district court judge is holding the hearing, he could issue an order requiring the debtor to appear and enforce that order through his contempt powers.

If the court finds that defendant has waived his exemptions by failure to assert them, the debtor may come in

any time before property is sold under an execution and move to set aside the waiver on the grounds that his failure to assert the exemptions was because of mistake, surprise or excusable neglect.

If the debtor does submit a schedule of his assets, the question at the hearing becomes the setting aside of the exemptions. G.S. 1C-1603(e)(2) provides that if no objection is made by a creditor, the judge may, if he finds it appropriate, enter an order designating the property scheduled by the debtor as ex mpt property. It, therefore, might be argued that since only a judge can designate the ex mptions as scheduled without any separate valuation, these cases should be scheduled before a judge. However, there is no reason why the clerk could not also make such a finding. Since the creditor is not objecting to the valuation, there would be no one to object to such a finding by the clerk. (The debtor will not object since it is his valuation that will be used.) If the creditor does not object to the schedule submitted by the debtor, the court issues an order setting aside the exemptions. The order could simply refer to the exemptions set out in the debtor's schedule.

If objection is made to the value of the property as scheduled by the defendant, the court must determine the value of the property. G.S. 1C-1603(e)(3) authorizes the court to appoint an appraiser to examine the property and report its value to the court. The person requesting the valuation must advance the costs of the appraiser. Those expenses are added to the claim as court costs. If the creditor objects to the valuation and then refuses to advance the costs of appointing an appraiser, the court has two options on how to proceed: (1) terminate the proceeding to enforce the judgment and make the creditor begin all over again when he tries to have execution issued; or (2) set off the exemptions based on the debtor's valuation in the schedule submitted by him. The latter procedure may be fairer to the debtor. And it would have to be followed if the debtor was the one who had filed the motion to have exemptions set aside.

The law provides that the court may provide for the sale of property having excess value and provide for appropriate distribution of the proceeds. Thus, if the judgment debtor has $10,000 equity interest in his residence, the court may order that the residence be sold, with the first $7,500 given to the debtor and the remaining to be applied toward the judgment. (The property is sold subject to any prior liens and encumbrances.) The clerk or judge should make sure that the order include a requirement that the bidding at the sale begin at the debtor's exemption; otherwise, the debtor's exemption will be cut off. Again, the statute is not clear whether the property would be sold under the judicial sale or

execution sale procedure. The original larger package would have repealed the execution sales statutes and had property sold under judicial sale statutes. Since the execution sales provisions remain, the easiest way to have the property sold is by the sheriff under an execution.

The statute also allows the debtor to substitute some exempt property in order to retain other exempt property having value in excess of the allowable exemption. For example, suppose a debtor had an interest of $9,500 in his residence. If he wants to retain that residence without having it sold for the $2,000 excess, he may ask the court to make his $1,000 interest in his motor vehicle subject to the judgment and only claim $1,500 (instead of $2,500) in value of his personal household belongings. Therefore, he would be turning over $2,000 of his personal property that otherwise could not have been reached in exchange for $2,000 more in his residence. Allowing substitution of property is in the court's discretion.

After determining the exemptions, the court must enter an order designating the exemptions. The clerk must docket in the judgment book a notation that the exemption has been set aside. Also, it would help title searchers to either keep an alphabetical index of debtors who have had exemptions designated or make a notation of the exemption on the index as well as the judgment book.

No provision for appeal is set out in the statute. Therefore, the general appeal provisions apply. If the district court judge sets aside the exemptions, appeal is to the court of appeals; if the clerk hears the matter, appeal is to the superior court judge.

Issuance of Execution Without Setting Aside Exemption

The statute allows the court to determine that particular property is not exempt even though there has been no proceeding to designate the exemption. This procedure will be used when the creditor is seeking to enforce a judgment to which the exemptions do not apply. For example, if an action is to enforce an order for child support, the clerk may issue execution to seize all property of the debtor without ever notifying the debtor of his rights or holding a hearing to set aside the exemptions. Likewise, if the judgment was for payment of a purchase money obligation, the clerk could issue an execution ordering the sheriff to seize and sell the specific property affected without setting aside any exemptions. The judgment creditor must make a showing satisfactory to the court that the claim he is seeking to enforce may be pursued without setting aside exemptions. In

many cases, the showing is made on the face of the judgment--a judgment for child support would be such an example. In other cases, the court may not be able to determine whether an exception to the exemption law exists without holding a hearing. For example, a hearing might be necessary to determine that the debtor is not a resident of North Carolina or that the claim was for the repair or improvement of the property the creditor is seeking to have seized and sold. If the court finds that the claim is excepted from the exemption law, the clerk can issue execution without setting aside exemptions. If only certain property is excepted--a claim to seize an automobile given as security when the creditor has a money judgment for default of the loan would be an example--the clerk would issue execution only as to the particular property.

EFFECT OF EXEMPTIONS

The statute allows the exemptions to be modified upon a change of circumstances. The effect of designating property as exempt is that the property is free of the enforcement of the claims of creditors for indebtedness for so long as the debtor owns the property. Presumably therefore, once the exemptions are set aside, a second judgment creditor need not have the exemptions set aside again. He may ask to have an execution issued to levy on and sell any property not listed as exempt unless the debtor files for a modification of the earlier exemption. As mentioned earlier, if a debtor is married one creditor may be able to reach property different from another depending on what property is held as tenants by the entirety and whether both spouses are debtors.

G.S. 1C-1604 provides that when property designated exempt is conveyed to another, the exemption ceases to liens attaching before the conveyance. That provision will apply to two kinds of property: Any exempt real property would have a judgment lien on it before it is transferred since the docketing of the judgment creates a lien on all of the real property owned by the debtor in the county where the judgment is docketed. In the situation where the debtor has claimed an exemption in household goods from a creditor who has a nonpurchase money security interest in the goods, a lien would have attached before the exempt goods were transferred. In the most common situation where the debtor has claimed his personal property as exempt and then transfers it, no lien would have attached when the property is transferred. A judgment lien does not attach to personal property until the sheriff seizes the property and places it under his control. (This provision made more sense when part of the larger bill because that bill provided a mechanism for creating a judgment lien on personal property held by the debtor without having a seizure by the sheriff.)

TRANSITIONAL ORDERS

The new law has an effective date of January 1, 1982, but provides that it applies to all proceedings begun before or after that date. Therefore, it applies to any executions outstanding on January 1 as well as those issued after January 1. The bill authorizes the court to enter appropriate transitional orders for proceedings begun before January 1. If the debtor has already had his constitutional exemptions set off under the former law, the court could order the sheriff to go forward with the execution as if there was no new law since the debtor has already received constitutional exemptions. If the sheriff has not levied on any property or if he has seized property but not yet sold it, the question becomes may the sheriff go forward with the execution and sale or must the debtor be given notice of and an opportunity to claim his exemptions. The law requires notice to the debtor to be given when a proceeding is begun. It can be argued that since the proceeding was begun (i.e., the execution issued) before January 1, the clerk is not required to cause notice to issue to the debtor. The court could issue a transitional order allowing the sheriff to go forward with all executions outstanding on January 1 unless the debtor comes forward and moves to have his exemptions designated. Another alternative would be for the court to require the creditor to move to set aside the exemptions and serve notice of rights and schedule on the debtor before allowing the sheriff to continue with the execution. If the clerk decides to follow the latter procedure, for executions under which no levy has been made, the simplest solution would be to order the sheriff to demand payment and return the execution if payment is refused.

SHERIFF'S DUTIES UNDER NEW LAW

The sheriff's duties under the new law will be easier than under the old law since the sheriff will no longer be responsible for setting aside exemptions. If a sheriff receives an execution requiring him to satisfy the judgment out of the funds of the debtor, he should use due diligence in locating the debtor and demanding payment. If the debtor agrees to make payment, a sheriff should hold the execution until payment is made (but remember it must be back to the clerk by the 90th day after it was issued) and then return the execution with the funds collected after deducting his commission. If the debtor refuses to make payment or says he cannot pay, a sheriff should return the execution making a return that payment was demanded and was refused by defendant.

A sheriff may receive an execution requiring him to satisfy the judgment out of the personal property of the defendant and if sufficient personal property does not exist out of the real property of the defendant, which is identical to the present order of execution. In that case the exemptions have been waived or no exemptions apply to the claim. A sheriff will carry out the execution in the same manner as he always has. He must use due diligence in discovering what property the defendant has and then levy on and sell enough property to satisfy the judgment. If the debtor asks for his exemptions, the sheriff should go ahead and levy on the debtor's property because the clerk has either determined that the debtor is not entitled to exemptions or that he has waived his right to exemptions by not filing the schedule. The only way he can have his exemptions set aside later is for the clerk or district court judge to set aside the waiver. That must be done by motion to the court. The sheriff should go forward with the execution until notified to stop by the court.

Sometimes the exemption law does not apply to a specific piece of property. In those cases the execution will order the sheriff to seize and sell a specific property.

And finally in some cases the debtor will have had his exemptions designated, and the execution will order the sheriff to satisfy the judgment out of defendant's property except that set off as exempt. The clerk will attach a copy of the order designating exempt property to the execution. That order will identify exempt property. A sheriff will be required to use due diligence to determine if the debtor has other property which would be subject to the execution. One place for the sheriff to look is the schedule filed by the debtor since it is supposed to include a listing of any nonexempt property owned by him. The execution might also include a special order to sell the excess interest in exempt property. For example, a defendant claims an exemption is his residence; the residence has a fair market value of $45,000; there is a $20,000 mortgage on the property; and the defendant's interest in the property is $20,000. Under the exemption law the defendant is only entitled to a $7,500 exemption. Therefore, the clerk might order the sheriff to sell the property (beginning the sale at $7,500 to cover the defendant's exemption). The defendant would then receive the first $7,500 from the sale and the remainder would be used to satisfy the judgment. The sheriff should return the entire amount of money paid at the sale except his commission. The commission would be figured on the amount collected above $7,500.

The new law places no duty on the sheriff to notify the defendant that he is entitled to any exemptions.

The biggest problem under the new will be how it will affect writs of possession for personal property when the plaintiff is a lender (bank or finance company) and the writ is to repossess household goods. As explained under the section on Exceptions to the Exemptions, the debtor may be able to assert his exemptions in these household goods. However, the best course for a sheriff to follow until the law is clarified is to continue to serve the writs as they are issued. If a debtor requests to have his exemptions set off, tell him he must go to the clerk and check with the clerk to see how to proceed.

Conclusion

Many questions are left unanswered by this new law. The best that court officials and sheriffs can hope is that everyone can muddle through for a while until the questions are answered.