

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MISSOURI
WESTERN DIVISION**

In re:)
)
TONY R. SMITH and) Case No. 01-44618
DARLENE K. SMITH,)
)
)
Debtors.)

MEMORANDUM OPINION

On October 23, 2003, Tommy R. Smith and Darlene K. Smith, the Debtors (“Debtors”) in these Chapter 13 proceedings, filed a Motion for Determination and Approval of Exemption, seeking approval to exempt monies they have received or will receive from the settlement of a sexual harassment injury lawsuit. Richard V. Fink, the Chapter 13 Trustee (“Trustee”), opposed the Motion, arguing that the Debtors did not properly claim the contingent and unliquidated asset as exempt and that the recovery the Debtors receive from the settlement should be paid into their Chapter 13 plan.

The Court held a hearing on this issue on November 5, 2003, in Kansas City, Missouri, ordered supplemental briefing, and took the matter under advisement. After reviewing the motions, supplemental briefing, and the relevant case law, the Court is now prepared to rule that the Debtors sufficiently claimed the lawsuit as an exempt asset and that the Trustee cannot now assert 11 U.S.C. § 1325(b) as a post-confirmation basis for increasing plan payments to the extent of the Debtors’ disposable income.

I. BACKGROUND

Before filing a Chapter 13 bankruptcy petition on September 19, 2001, Darlene Smith, through her attorney, had filed a sexual harassment lawsuit against Sony Corporation and Adecco Employment Services. In their joint bankruptcy petition, Darlene and her husband, Tony Smith, listed the claim in Schedule B as contingent and unliquidated with an “unknown” value, and claimed the lawsuit as an exempt asset in Schedule C, pursuant to Mo. Rev. Stat. § 513.427, again listing the value of the lawsuit

as “unknown” and stating that it was exempt in the amount of “\$0.00.” The Trustee neither objected to the Debtors’ claim that the lawsuit was an exempt asset nor objected under 11 U.S.C. § 1325(b) to confirmation of the Debtors’ Chapter 13 plan. The plan was confirmed by the Court on January 10, 2002, and all Chapter 13 plan payments have been timely paid to the Trustee.

On October 9, 2002, the Trustee filed a motion to have the Debtors’ case dismissed for an alleged “failure to cooperate” with the Trustee because the Debtors had never obtained court approval for their attorney to continue representation of them in the sexual harassment lawsuit. In an effort to avoid dismissal, the Debtors filed a motion to retain their attorney and disclosed the terms of that employment. Subsequently, in the fall of 2003, the Debtors agreed to settle their sexual harassment claim for approximately \$18,000.00. They then filed the instant Motion seeking court approval of their claimed exemptions so that they would not have to surrender the proceeds of the lawsuit to the Trustee.¹

II. DISCUSSION

The Debtors advance two arguments as to why the proceeds from the sexual harassment lawsuit should not be payable to the creditors in their Chapter 13 plan. First, the Debtors assert that the Trustee is now barred from objecting to the exemption because he did not object to their exemption of the sexual harassment lawsuit prior to plan confirmation. Second, if the Trustee is allowed to assert an untimely objection, the Debtors contend that the lawsuit was properly claimed as an exempt asset pursuant to Mo. Rev. Stat. § 513.427, and any objection should be denied on the merits. In opposition, the Trustee contends that he was not required to object prior to plan confirmation because the value of the lawsuit was listed as “unknown” and the amount of the exemption was listed as “\$0.00.” Because the Debtors failed to exempt any specific amount, the Trustee asserts, he had no reason to object. Further, the Trustee argues that the settlement constitutes disposable income, and because it was received within three years of the first plan payment, it must be turned over for distribution to the Debtors’ creditors.

A. Failure to File an Objection Before Confirmation of a Chapter 13 Plan

¹ Presumably, the Motion was filed because the Trustee demanded that the Debtors turn the net settlement proceeds over to the Trustee, although no evidence of such a demand was adduced. If that was not the case, there would be no apparent purpose for filing the Motion.

The Debtors first assert that the Trustee is barred from raising an objection to their claim of exemption for the sexual harassment lawsuit because the Trustee did not file a timely objection. The Court agrees.

Property claimed by a debtor as exempt is in fact exempt unless a party in interest objects. 11 U.S.C. § 522(l). Pursuant to Fed. R. Bankr. P. 4003(b), a party in interest has thirty days after the 11 U.S.C. § 341(a) meeting of creditors to file an objection to a debtor's claim of exemptions. A failure to timely object to a claimed exemption prevents a trustee from later challenging that exemption – even if the debtor does not have a good faith or reasonably disputable basis for claiming it. *Taylor v. Freeland & Krontz*, 503 U.S. 638, 642-44, 112 S. Ct. 1644, 118 L. Ed. 2d 280 (1992) (stating that “[d]eadlines may lead to unwelcome results, but they prompt parties to act and produce finality.”). In this case, no objections were timely filed concerning the Debtors' claim that their sexual harassment lawsuit was an exempt asset under Mo. Rev. Stat. § 513.427. Under the Supreme Court's holding in *Taylor*, the Trustee is now prohibited from challenging the validity of that exemption. The Court is unaware of any statutory provision that excuses a Chapter 13 trustee from this requirement to timely object to an allegedly improper exemption.

B. Effect of Scheduling an Exemption of a Contingent and Unliquidated Claim at “\$0.00”

The Trustee asserts that the Debtors listed the value of the sexual harassment lawsuit as “unknown” and only claimed “\$0.00” of that “unknown” amount as exempt pursuant to Mo. Rev. Stat. § 513.427; thus, pursuant to the Debtors' own statement, the Trustee seeks to limit the amount of the exemption to \$0.00. The Debtors contend they properly exempted the entire claim.

Consonant with the Trustee's position, some courts have held that a debtor is limited to the amount of the claimed exemption as stated in the debtor's schedules. *See e.g., Addison v. Reavis*, 158 B.R. 53, 60-61 (E.D. Va. 1993) (holding that the debtor who exempted \$1.00 of a homestead with a reported value of \$1.00 was limited to the amount of the claimed exemption), *aff'd sub. nom. Ainslie v. Grablowsky*, 32 F.3d 562 (4th Cir. 1994) (unpub.). Other courts have determined that the intent of the debtor as manifested in the schedules controls the extent to which an asset is exempted regardless of the actual value assigned to the amount of an exemption. *See, e.g., Taylor*, 503 U.S. at 643 (allowing the debtor to exempt the entire amount of an unliquidated claim when the debtor valued the claim as “unknown” and also claimed the asset as exempt); *Allen v. Green (In re Green)*, 31 F.3d 1098, 1100-01 (11th Cir. 1994) (allowing a personal injury settlement of \$15,000.00 to be exempted

in its entirety when the debtor had scheduled the contingent and unliquidated auto accident claim as having a value of \$1.00 and also claiming \$1.00 as exempt – the trustee understanding that the actual value of the claim was not \$1.00 and that the stated amount was used to signify an unliquidated claim). In the Eighth Circuit, when the amount of a debtor’s allowed exemption is limited by a maximum dollar amount under the applicable statute, and when the debtor schedules the contingent asset’s value as “unknown” – while also claiming the amount exempted as “unknown” – the debtor is only permitted to exempt the asset up to the statutory maximum even though no objection was filed. *Stoebner v. Wick (In re Wick)*, 276 F.3d 412, 416 (8th Cir. 2002). Thus, an unchallenged exemption may only be partially exempt when the authority for claiming that exemption provides a specific dollar cap. In yet another variation, the Bankruptcy Appellate Panel for the Eighth Circuit determined that when a debtor claims an asset as exempt and lists the exemption value as less than the current market value of the asset, then the debtor is limited to the stated value of the exemption. *Soost v. NAH, Inc. (In re Soost)*, 262 B.R. 68, 73-74 (B.A.P. 8th Cir. 2001) (holding that a debtor had failed to exempt the entire asset when the debtor valued the asset at \$26,000.00 but claimed only \$1.00 as exempt).

Here, the Debtors could have avoided all confusion by simply stating that the value of their contingent and unliquidated sexual harassment lawsuit was “unknown” and that they claimed 100% of that contingent and unliquidated asset as exempt.² But the Debtors did not do so. Instead, the Debtors chose to list the value of the asset as “unknown” and claim “\$0.00” as exempt. While the Court notes that claiming \$0.00 as exempt serves no useful purpose, and that time and ink could be conserved by simply omitting the lawsuit from the schedule of exempt assets, the fact remains that the Debtors’ intent can be fairly ascertained simply because the Debtors listed the lawsuit on the schedule of exempt assets. Rather than stating a positive amount for the extent of the claimed exemption, the Debtors only stated that the basis for the exemption was Mo. Rev. Stat. § 513.427. Thus, the only fair inference based on the Debtors’ Schedule C is that they claimed the lawsuit exempt to the extent allowed by the authorizing statute.

The Trustee does not appear to have been misled by the Debtors’ representations. In the Trustee’s response to the Debtors’ present Motion, the Trustee stated that he interpreted the “\$0.00” listed on Schedule C as meaning “unknown,” and based on the “unknown” amount listed as exempt for

² The Court would commend this practice to all attorneys.

a contingent and unliquidated asset of an “unknown” value, the Trustee took the position that no amount was exempt. (Document No. 39, ¶ 4). The Trustee’s position is contrary to *Taylor, Wick, and Green, supra*. Accordingly, the Court finds that the Debtors sufficiently claimed an exemption of their sexual harassment lawsuit to the maximum extent allowable by law because the lawsuit was listed on the schedule of exempt assets, the value of that asset was “unknown,” the Trustee interpreted the “\$0.00” figure as an attempt to exempt an asset of an “unknown” value in an “unknown” amount, and the Debtors provided the authorizing statute that provided the basis for their exemption.³

C. Extent to Which a Sexual Harassment Settlement is Exempt Under Mo. Rev. Stat. § 513.427

Pursuant to the Eighth Circuit’s ruling in *Wick*, 276 F.3d at 416, the Debtors are only allowed an exemption – even when uncontested by the Trustee – to the maximum extent allowable by law. The Debtors claimed that their sexual harassment lawsuit was exempt pursuant to Mo. Rev. Stat. § 513.427. That statute states:

Every person by or against whom an order is sought for relief under Title 11, United States Code, shall be permitted to exempt from property of the estate any property that is exempt from attachment and execution under the law of the state of Missouri or under federal law, other than Title 11, United States Code, Section 522(d), and no such person is authorized to claim as exempt the property that is specified under Title 11, United States Code, Section 522(d).

Mo. Rev. Stat. § 513.427.

This provision is Missouri’s “opt-out” statute, making the federal exemptions listed in 11 U.S.C. § 522(d) inapplicable to cases filed in Missouri. It does not provide an independent basis for exempting an asset of the estate. A non-exclusive list of exemptions is available in Mo. Rev. Stat. § 513.530, but there are numerous other exemptions not listed in that section or in any other section of Chapter 513. *In re Sanders*, 69 B.R. 569, 572 (Bankr. E.D. Mo 1987). While § 513.427 does not form an independent basis for exempting any asset, courts have construed the language “under the law of the state of Missouri” as covering exemptions created by both statutory and constitutional law, as well as common law. *In re Mitchell*, 73 B.R. 93 (Bankr. E.D. Mo 1987). Under Missouri jurisprudence, personal injury claims are not assignable to creditors. *In re Kininson*, 177 B.R. 632,

³ There is, of course, an inherent danger in ascribing a value to a contingent and unliquidated claim such as this one. Most importantly, placing a precise dollar amount on the value of the claim could affect significantly the Debtors’ position in settlement negotiations or in mediation and might be used against them at a later trial.

634 (Bankr. E.D. Mo. 1995) (“Under Missouri law, a tort claim ‘in which the wrong is regarded as one to the person rather than the injury affecting the estate or property’ is not assignable.”) (quoting *Scarlett v. Barnes*, 121 B.R. 578 (Bankr. W.D. Mo. 1990)). “Because injuries affecting personal rather than property interests are not assignable under Missouri law, these types of actions are also exempt under RSMo. § 513.427.” *Id.*

Even though a claim for sexual harassment constitutes a personal injury and is exempt from attachment under Missouri law, it is only exempt to the extent that the damage award is not compensation for property damage. *Id.* at 634-35. Thus, recoveries for lost wages or punitive damages are not compensation for personal injury and may be attachable by creditors. *Id.* at 635. Any attachment, however, must occur after the claim is liquidated because an unliquidated litigation claim that seeks a mixture of personal injury and property damage compensation is exempt in its entirety in its unliquidated state. *In re Williams*, 293 B.R. 769, 777 (Bankr. W.D. Mo. 2001) (stating that “more than a century of case law holds that either pending or potential causes of action arising out of a personal injury tort are exempt in their entirety,” and inviting the Missouri General Assembly to codify the exemption laws for personal injury lawsuits).

In this case, the Debtors’ unliquidated sexual harassment lawsuit sought compensation, in part, for physical injuries. Thus, the Debtors’ litigation claim was wholly exempt at the time their schedules were filed pursuant to Mo. Rev. Stat. § 513.427 and the interpreting case law. The Debtors properly claimed the lawsuit as exempt under the authority of § 513.427, and it was wholly exempt at the time the Court confirmed their Chapter 13 plan. Furthermore, after the Debtors’ Chapter 13 plan was confirmed by the Court, all property of the estate vested in the Debtors, 11 U.S.C. § 1327(b); thus, when the lawsuit was liquidated, even the portion that would have been non-exempt if the claim was liquidated prior to confirmation belongs to the Debtors.⁴

D. Settlement Constituting “Disposable Income”

Despite the fact that an unliquidated personal injury lawsuit is wholly exempt from attachment at the time the Court confirms the Debtors’ Chapter 13 plan, the Trustee asserts that he should be

⁴ Neither party adduced evidence as to what portion, if any, of the settlement is attributable to lost wages or punitive damages.

allowed to attach the non-exempt portions of that asset, under the authority of 11 U.S.C. § 1325(b),⁵ once the claim is liquidated because the monies were received by the Debtors within three years of their first payment under the Chapter 13 plan. The Trustee contends that even if a portion of the asset is exempt, the value of that asset is still included in calculating the amount of the Debtors' disposable income that must be paid into the Chapter 13 plan.

Pursuant to 11 U.S.C. § 1325(b), if the Trustee objects to confirmation of a plan, then the Court may only approve the plan if the plan provides that all of the Debtors' "projected disposable income to be received in the three-year period ... will be applied to make payments under the plan." 11 U.S.C. § 1325(b)(1)(B). By its express terms, however, § 1325(b) requires the Trustee to object to confirmation prior to the invocation of the disposable income test. *See Midkiff v. Stewart (In re Midkiff)*, 342 F.3d 1194, 1202 (10th Cir. 2003) (stating that the "disposable income" requirement in subsection (b)(1)(B) is conditional on the trustee or a holder of an allowed secured claim making an objection; and because no relevant party objected to the plan confirmation the ensuing conditions were not relevant); *In re Grissom*, 137 B.R. 689, 691 (Bankr. W.D. Tenn. 1992) ("The time to require the application of the disposable income test is established by § 1325(b) as being at the confirmation hearing, and its application is triggered in only one way, that is, by the filing of an objection to the plan's confirmation."). *See also Forbes v. Forbes (In re Forbes)*, 215 B.R. 183, 188 (B.A.P. 8th Cir. 1997).

⁵ That section states:

- (1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan--
 - (A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
 - (B) the plan provides that all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.
- (2) For purposes of this subsection, "disposable income" means income which is received by the debtor and which is not reasonably necessary to be expended--
 - (A) for the maintenance or support of the debtor or a dependent of the debtor, including charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3)) to a qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4)) in an amount not to exceed 15 percent of the gross income of the debtor for the year in which the contributions are made; and
 - (B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

11 U.S.C. § 1325(b).

The Court acknowledges that the plain language of § 1327(a) only states that the “confirmed plan binds the debtor and each creditor,” and no mention is made of the trustee. The Court believes that this is a distinction without a difference and once a confirmed plan is given *res judicata* effect – in the absence of a specific statutory exception – that effect also binds the trustee, who was a party to the confirmation proceeding. *See, e.g., Ledford v. Brown (In re Brown)*, 219 B.R. 191, 194 (B.A.P. 6th Cir. 1998) (“A trustee is considered a party to a confirmation proceeding, and, as such, is bound by the proceedings.”); *In re Mitchell*, 281 B.R. 90, 94 (Bankr. S.D. Ala. 2001) (“Plan confirmation orders bind debtors, creditors, trustees and other parties in interest.”); *In re Hudson*, 260 B.R. 421, 435 (Bankr. W.D. Mich. 2001) (same); *In re Hallmark*, 225 B.R. 192, 195-96 (Bankr. C.D. Cal. 1998) (stating that the trustee is bound by confirmation of the plan and the only way to change that is to seek modification).

Here, the Debtors’ Chapter 13 plan was confirmed by the Court on January 10, 2002, and the Trustee never filed an objection based on 11 U.S.C. § 1325(b). Accordingly, the Trustee cannot now assert 11 U.S.C. § 1325(b) as a basis for bringing the proceeds of the settlement into the confirmed plan.⁶

F. Practical Effect of Court’s Determinations

The Court recognizes that its conclusions of law may require greater diligence by the Chapter 13 Trustee. First, the Trustee’s failure to object within 30 days to debtors’ exemptions of contingent and unliquidated claims will likely prevent the Trustee from later objecting to the exemptions. The Trustee would be well-advised to object to exemptions if he believes that they are improperly claimed or that a portion of the claim should be paid into the Chapter 13 plan for distribution to creditors. Such a practice would have the salutary effect of establishing early in the proceedings how the claim will be handled upon liquidation. Secondly, a failure to object under 11 U.S.C. § 1325(b) prior to plan confirmation any time a debtor lists a contingent and unliquidated lawsuit will preclude a post-confirmation objection on those grounds in the event the asset is later liquidated. Once confirmed, the plan is given a *res judicata* effect and binds the debtor, creditors, and the trustee. At first glance, it might seem patently unfair that the debtor may use a pre-confirmation asset of the estate to receive a

⁶ Because the Court finds that the Trustee failed to make a timely objection pursuant to § 1325(b), the Court need not reach the issue of whether the value of an exempt asset can form the basis for increasing the amount of a debtor’s disposable income payable to the plan.

post-confirmation windfall at the expense of creditors, when had the asset been liquidated at the time of filing that same money could have been distributed to creditors under the Chapter 13 plan. On the other hand, any unfairness to creditors must be measured against the underlying policies of Chapter 13, and the creditors can receive some comfort that they will always receive at least as much in a Chapter 13 plan as in a Chapter 7 liquidation.

In practicality, the situation is not dire. First, in cases where the debtor fails to claim an exemption in a contingent and unliquidated asset, that asset may be available for distribution to creditors regardless of any § 1325(b) objection to confirmation. Even though the confirmation of a debtor's plan vests all of the property of the estate in the debtor under § 1327(b), the contingent and unliquidated asset would have been property of the estate in a Chapter 7 proceeding; thus, when the asset is liquidated, the trustee may seek to modify the plan to increase the payments pursuant to §§ 1329(a)(1) and 1325(a)(4).

Second, in situations where the debtor claims a legally authorized exemption with a specific dollar cap, and where the trustee fails to object prior to confirmation of a Chapter 13 plan, then any amount received above that cap may be payable to creditors. This is because, in a case arising under Chapter 7 of the Code, any amount in excess of the statutory dollar cap would be payable to creditors; thus, the Chapter 13 trustee can reach the same funds through a motion for modification.

It is the third situation in which the instant case arises. When the debtor claims as totally exempt an asset that is not subject to a statutory cap but that is only partially exempt when liquidated, the failure of the Chapter 13 trustee to object is fatal. Because the asset is wholly exempt at the time of filing and cannot be split, it would not become property of the estate under Chapter 7 of the Bankruptcy Code and Missouri jurisprudence. It is only in this situation that the Chapter 13 trustee must object, if at all, under § 1325(b) if the trustee has any chance of recovering the non-exempt proceeds of a liquidated lawsuit after confirmation. Otherwise, the proceeds of the litigation, in its entirety, vest in the debtor as long as those proceeds are received post-confirmation.⁷

⁷ Not addressed in the Court's Memorandum Opinion are the issues of whether a debtor's disposable income – in light of a timely 11 U.S.C. § 1325(b) objection – includes exempt property, and the effect, if any, of a Chapter 13 debtor's Fed. R. Bankr. P. 1009 amendment to the exemption schedules in light of the debtor's duty to file accurate schedules and the *res judicata* effect of the confirmed plan.

III. CONCLUSION

The Court will grant the Debtors' Motion for Determination and Approval of Exemption and allow the exemption in its entirety, because no party timely filed an objection and because the statements contained on the Debtors' Schedule C were sufficient to exempt an asset of an "unknown" value to an "unknown" amount which, in turn, is sufficient under Eighth Circuit jurisprudence to exempt that asset to the maximum extent allowable by the authorizing law. In this case, the unliquidated litigation claim included damages for personal injury and was thus wholly exempt at the time the Debtors filed their schedules. After confirmation, the right to the non-exempt portion of the litigation proceeds vested in the Debtors.

Pursuant to the Trustee's request in his response to the Debtors' Motion, the Court will not order that plan payments be increased to the extent of the Debtors' disposable income pursuant to 11 U.S.C. § 1325(b) because no party objected on the grounds stated in that subsection prior to the confirmation of the Debtors' Chapter 13 plan. While the Trustee may seek to modify the Debtors' Chapter 13 plan, if warranted, to increase the amount of plan payments to creditors, such a motion is not before the Court at this time.

This opinion constitutes the Court's findings of fact and conclusions of law pursuant to Fed. R. Bankr. P. 9014. A separate order shall be entered pursuant to Fed. R. Bankr. P. 9021.

ENTERED this 6th day of January 2004.

/s/ Jerry W. Venters
HONORABLE JERRY W. VENTERS
UNITED STATES BANKRUPTCY JUDGE

A copy of the foregoing was served electronically or conventionally to:

Richard V. Fink
Kenneth Eitel