

**UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION**

IN RE:

FRANK WICKS
MARCLE WICKS,

Case No. 91-27183-L
Chapter 7

Debtors.

**MEMORANDUM OPINION AND ORDER ON DEBTORS'
MOTION TO REQUIRE PAYMENT FROM BANKRUPTCY
ESTATE OF \$7,500 PERSONAL INJURY EXEMPTION**

Before the court is the Debtors' motion to require the case trustee, Norman P. Hagemeyer, to distribute \$7,500 from the bankruptcy estate to the Debtors allegedly representing the exempt portion of the Debtors' settlement of a personal injury suit. The Trustee filed a response to the motion in which he asks that the motion be denied on the basis that Mrs. Wicks has previously received \$10,340 in advances from the attorney who represented her in the personal injury suit. Based upon the statements of counsel for the Debtors and the Chapter 7 Trustee, and the court's review of the case file, the court concludes that the Debtors' motion should be granted.

FACTUAL AND PROCEDURAL HISTORY

This bankruptcy case was originally filed under Chapter 13 of the Bankruptcy Code on July 10, 1991, but later converted to Chapter 7 on October 5, 1995, at the request of the Debtors.

No proof was offered concerning the date of the Debtors' injuries, but the case file contains a copy of a contract between the Debtors and Mr. Lewis K. Garrison, Sr., attorney, which indicates that the Debtors were injured in an automobile accident on April 6, 1991. The date of the

contract was April 9, 1991. Even though the accident apparently occurred prior to the filing of the original petition in this case, the personal injury claim was not listed as an asset on the Debtors' original schedules, and thus no exemption was claimed.

During the period of May 16, 1991, through August 8, 1993, during the administration of the Chapter 13 plan, Mr. Garrison made a series of thirty-three loans to Mrs. Wicks in the aggregate amount of \$10,340, reportedly for the purpose of permitting her to receive medical treatment and medications. Each loan was evidenced by a promissory note payable on demand to bearer which further specified, "I hereby assign the proceeds from any settlement or judgment for bodily injury and property damage to be applied to repayment of this loan to the bearer hereof."

The case file does not reflect when the Debtors agreed to settle their personal injury claim, but it appears that the agreement pre-dated the voluntary conversion of the case to Chapter 7 on October 5, 1995. Upon conversion, the Debtors filed new bankruptcy schedules in which the Debtors did list their personal injury claim as an asset with an estimated value of

\$27,000 (the amount of the settlement ultimately approved by this court), and claimed an exemption of \$7,500 in the proceeds pursuant to Tennessee Code Annotated § 26-2-111(2)(B).¹

¹Tenn. Code Ann. § 26-2-111 provides in pertinent part:

26-2-111. Additional exemptions — Certain benefit payments — Awards — Tools of trade — Health care aids. — In addition to the property exempt under § 26-2-102, the following shall be exempt from execution, seizure or attachment in the hands or possession of any person who is a bona fide citizen permanently residing in Tennessee:

(2) The debtor's right not to exceed in the aggregate fifteen thousand dollars (\$15,000) to receive or property that is traceable to:

(B) A payment, not to exceed seven thousand five hundred dollars (\$7,500) on account of personal bodily injury, not including pain and suffering or compensation for actual pecuniary loss, of the debtor or an individual of whom the debtor is a dependent.

The Debtors also listed in their Chapter 7 schedules a debt to their attorney, Mr. Garrison, in the amount of \$19,000 for “attorney fees.” The Debtors did not disclose that some part of this debt actually resulted from loans made by Mr. Garrison to Mrs. Wicks for medical expenses, and the Debtors did not indicate that any portion of this debt was secured.

On December 11, 1995, a “Petition² for Order Approving Settlement and Dismissal of Tort Lawsuit and Allowing Debtors and Attorney to Execute Settlement Papers” was filed by the attorney for the defendant in the Debtors’ personal injury lawsuit. That motion was heard by Bankruptcy Judge Bernice B. Donald, on January 11, 1996, resulting in the entry of an order requiring the Debtors to execute all documents necessary to resolve their personal injury lawsuit in return for a payment of \$27,000 to the Trustee. Thereafter, on February 6, 1996, the Trustee gave notice to all creditors of the need to file proofs of claim due to the recovery of assets.

²In a bankruptcy case, only the original pleading requesting the entry of an order for relief is properly styled a “petition.” *See* 11 U.S.C. §§ 301, 302(a) and 303(b). Subsequent pleadings may be motions or applications, but are not petitions.

No application was made to employ Mr. Garrison while the Debtors' bankruptcy case was being administered under Chapter 13. In fact, no application was made to employ Mr. Garrison until after Mr. Garrison filed a "Petition for an Order Approving Attorney Fees, Expenses and Advancements" on January 19, 1996. An objection to this application was filed by Mr. Hagemeyer on the basis that the attorney was entitled to a fee of no more than one-third of the \$27,000 recovery, but that other fees and advances described were not part of the Debtors' agreement with Mr. Garrison. Thereafter, on March 5, 1996, Mr. Garrison filed an Application on his own behalf to have himself employed as attorney for the Debtors³ in the personal injury suit. To this application, the United States Trustee objected on the basis that the cause of action belonged to the case Trustee, not the Debtors, and that Mr. Hagemeyer had not sought to employ Mr. Garrison. At a hearing, concern was raised by Bankruptcy Judge William Houston Brown about the propriety of the loans made by Mr. Garrison to his client in light of Tennessee Supreme Court Rule 8, DR 5-103(b), which restricts an attorney's advances to a client to those made for the expenses of litigation. Mr. Garrison subsequently withdrew his request for reimbursement of the loans made to Mrs. Wicks. Thereafter, on April 24, 1996, Judge Brown entered an order awarding Mr. Garrison an attorney's fee of \$9,000 (one-third of the settlement

³Actually, Mr. Garrison's application erroneously asks that he be employed as attorney for the "applicant" (himself).

amount) and reimbursement of litigation expenses advanced in the amount of \$461.20. Those amounts were paid by the Trustee.

The order entered by Judge Brown on April 24, 1996, specifically reserved all issues arising from purported assignments made by the Debtors as to certain medical providers pending the filing of appropriate pleadings by the case Trustee or other parties concerning the allowance of those claims, and the Trustee was ordered not to disburse any claimed exemption to the Debtors pending resolution of all claims to the personal injury recovery remaining after payment of the fees and expenses authorized therein. The case file reflects no action taken by the Trustee or any medical providers as the result of this order.

The Debtors' motion to require the payment of the claimed exemption was filed on February 18, 1997, some ten months after the referenced order of Judge Brown. It was only in response to the Debtors' motion that the Trustee, for the first time, raised any objection to the exemption claimed by the Debtors. The Trustee's response to the Debtors' motion argues that:

If the debtor, Marcle A. Wicks, is allowed the \$7,500 exemption then she will have received \$7,500 plus \$10,340 already advanced by Lewis Garrison, Attorney, for a total of \$17,840, which is more than two-thirds of the recovery in this case. This does not take into account that in a normal personal injury case the debtor would not be paid anything until the medical assignments and hospital liens are satisfied. These medical assignments and hospital liens in this case total at least \$4,881.48.

At the hearing on the Debtors' motion, the Trustee offered no proof beyond the stipulation of the parties that advances were made to Mrs. Wicks by her attorney. The parties

were invited to file legal memoranda, but chose not to. The matter was submitted on the stipulations of fact, the statements of counsel and the case file.

DISCUSSION

A. Timeliness of Debtors' Claim of Exemption

As an initial matter, although not specifically raised by the Trustee, the court considers the propriety of the Debtors' waiting to disclose their personal injury claim until after the conversion of their case to Chapter 7.

Upon the filing of a voluntary petition, or within fifteen days thereafter if the petition is accompanied by a list of all the debtor's creditors and their addresses, the debtor must file schedules of all assets and liabilities, a schedule of current income and expenditures, a schedule of executory contracts and unexpired leases, and a statement of financial affairs. Fed. R. Bankr. P. 1007(b)(1). In addition, the debtor or, if the debtor fails to do so, a dependent of the debtor, is required to file a list of property claimed as exempt under 11 U.S.C. § 522(b). 11 U.S.C. § 522(l). Schedules and statements filed prior to the conversion of a case to another chapter are deemed filed in the converted case unless the court orders otherwise. Fed. R. Bankr. P. 1007(c). In this district, pursuant to Local Bankruptcy Rule 1017-1, all debtors are required to file new lists, statements and schedules upon conversion.

Under Bankruptcy Rule 1009(a), "[a] voluntary petition, list, schedule or statement may be amended by the debtor as a matter of course at any time before the case is closed." Fed. R.

Bankr. P. 1009(a). Rule 1009(a) has been interpreted to prohibit a court from denying a debtor's request to amend in a voluntary case unless a creditor demonstrates the debtor's bad faith or prejudice to creditors. *In re Sandoval*, 103 F.3d 20, 22 (5th Cir. 1997); *In re Yonikus*, 996 F.2d 866, 872 (7th Cir. 1993); *Lucius v. McLemore*, 741 F.2d 125, 127 (6th Cir. 1984).

There are a number of troubling facts in this case. The court is concerned by the Debtors' failure to disclose the existence of their personal injury claim in their original schedules and statements; their resulting failure to claim any exemption in the personal injury claim in their original schedules and lists; their failure to disclose and seek approval of the loans made by Mr. Garrison during the administration of their Chapter 13 plan; the obvious correlation between the settlement of their personal injury claim and the conversion of their case to Chapter 13 with less than one year remaining for completion of their plan payments; and the Debtors' apparent failure to disclose the pendency of their bankruptcy case to Mr. Garrison or, if they did, his initial failure to seek bankruptcy court approval of the settlement.⁴ Such facts could be interpreted as an attempt to conceal the existence of the personal injury claim from this court.

⁴The case file contains a copy of an order entered by the circuit court judge on December 1, 1995,

setting aside the dismissal of the personal injury suit and reinstating the cause,
[U]pon notification to the court by Counsel for Plaintiffs and Defendant
that the Plaintiffs have filed a Petition in the United States Bankruptcy
Court and that the Dismissal entered on November 16, 1995, should be
set aside and the cause reinstated pending further order from the United
States Bankruptcy Court.

Nevertheless, the Trustee carries the burden of establishing, by clear and convincing evidence, that an amendment to the Debtors' schedules should not be allowed due to the Debtors' bad faith or prejudice to creditors. *In re Yonikus*, 996 F.2d 866, 872 (7th Cir. 1993). The Trustee has not alleged that the Debtors in this case acted in bad faith in amending their schedules. This case is distinguishable from *Yonikus* and other similar opinions because in this case, it was not the Trustee's discovery of the personal injury claim that led to the Debtors' amendment. Although the court is troubled by the lack of disclosure by the Debtors during the administration of their Chapter 13 plan, without more the court cannot conclude that such omissions resulted from bad faith on the part of the Debtors. Likewise, the Trustee has not demonstrated any prejudice to the creditors that resulted from the omissions. If anything, the advances from Mr. Garrison may have enabled the Debtors to continue making their plan payments a little longer resulting in greater distributions to the unsecured creditors. Thus, while the court does not condone the omissions in the original schedules, lists and statements, the court concludes that the amendments to the Debtors' schedules and lists to add the personal injury claim as an asset and to claim their exempt portion of it were proper.

B. Timeliness of the Trustee's Objection

The court next considers whether the Trustee's objection to the Debtors' claim of exemption is timely. Bankruptcy Code § 522(l) provides that "[u]nless a party in interest

objects, the property claimed as exempt on such list is exempt.” Bankruptcy Rule 4003(b) specifies that

any such objection must be filed within thirty days after the conclusion of the meeting of creditors held pursuant to Rule 2003(a) or the filing of any amendment to the list or supplemental schedules unless, within such period, further time is granted by the court.

Fed. R. Bankr. P. 4003(b). The requirement of a timely objection to a claimed exemption is to be strictly construed. *Taylor v. Freeland & Kronz*, 503 U.S. 638, 112 S.Ct. 1645, 118 L.Ed.2d 280 (1992). In *Taylor*, the Court concluded that a Chapter 7 trustee cannot contest the validity of a claimed exemption after the thirty-day period for objecting has expired and no extension is obtained, even where the debtor has no colorable basis for claiming the exemption. *Id.*, 112 S.Ct. at 1646.

Bankruptcy Rule 1019 deals with the effects of conversion upon various deadlines. Neither Bankruptcy Rule 4003(b) nor Rule 1019, however, specifically provides for a new thirty-day period for objecting to a debtor’s claimed exemptions when a case is converted from Chapter 13 to Chapter 7. Chief Bankruptcy Judge Paskay of the Middle District of Florida has rather compellingly concluded that the Chapter 7 trustee should have an opportunity to object to a debtor’s claimed exemptions if he does so within thirty days of the meeting of creditors held after the conversion. *In re Lyle*, 166 B.R. 972, 974 (Bankr. M.D. Fla. 1994). In this case, however, the filing of the Debtors’ new lists, schedules and statements resulted in several

amendments to the original schedules. Bankruptcy Rule 4003(b) clearly supplies a new thirty-day period for objection to a claimed exemption after amendment. In this case, the Trustee failed to object to the Debtors' claimed exemption either within thirty days after the filing of the amendment or within thirty days after the meeting of creditors following the conversion. Although the Trustee styled his pleading a "response" to the Debtors' motion rather than an objection to the claimed exemption, he nevertheless seeks denial of the exemption. To the extent that the "response" constitutes an objection to the claimed exemption, the objection is not timely.

C. Debtors' Right to Exempt Proceeds

Further, even if it were timely filed, the response contains no basis upon which the claimed exemption could be denied. The issue decided in *Taylor* was whether a trustee may contest the *validity* of an exemption after the thirty-day period if the debtor had no colorable basis for claiming the exemption. *Taylor*, 112 S.Ct. at 1646 (emphasis added). In that case, the debtor claimed as exempt her state employment discrimination claim against her employer, TransWorld Airlines (TWA). She described the property claimed as exempt as “Proceeds from lawsuit — [Davis] v. TWA” and “Claim for lost wages” and listed its value as “unknown.” *Id.* The trustee testified that he did not object to the claimed exemption because in his experience many debtor’s lawsuits do not turn out to be advantageous or settle within the exemption limitation. *Id.* at 1647. The bankruptcy court concluded that the debtor had “no statutory basis for claiming the proceeds of the lawsuit as exempt.” *Id.* (citing *In re Davis*, 105 B.R. 288 (W.D. Pa. 1989)). The district court affirmed, but the Court of Appeals for the Third Circuit reversed. The Supreme Court granted certiorari and affirmed the Third Circuit.

The trustee in *Taylor* argued that “courts may invalidate a claimed exemption after expiration of the 30-day period if the debtor did not have a good faith or reasonably disputable basis for claiming it.” *Id.* at 1648. Because the debtor did not have a statutory basis for claiming all of the lawsuit proceeds as exempt, the trustee asserted she lacked good faith. *Id.*

The Supreme Court summarily rejected the trustee's argument, stating that it had "no authority to limit the application of § 522(*l*) to exemptions claimed in good faith." *Id.* at 1649.

The facts in this case are different from those in *Taylor*. The Trustee does not assert that the Debtors have claimed an exemption to which they are not statutorily entitled or in an amount beyond statutorily prescribed limits. In their schedules, the value of the Debtors' claimed exemption is listed at \$7,500, the statutory amount, and the appropriate Tennessee exemption statute is specifically referenced. The Trustee does not argue that there is no colorable basis for the claimed exemption, for indeed it appears that there is.

The Trustee in this case argues instead that although the Debtors' claim of exemption is proper, the Debtors nevertheless will receive more than the statutorily provided amount because of the \$10,340 advanced by Mr. Garrison.⁵ In effect, the Trustee appears to argue that the Debtors have already received the exempt portion of the recovery on the personal injury claim.

⁵The Trustee also asserts that nothing should be distributed to the Debtors until some \$4,881.48 in medical assignments and hospital liens are satisfied. The Trustee offered no proof of the validity of these asserted liens and assignments, however.

While this argument is initially appealing, it must ultimately fail. The advances from Mr. Garrison were not proceeds of the personal injury claim. They were loans that Mr. Garrison attempted to secure by an assignment of the proceeds of the personal injury claim. Because of the attorney-client relationship between Mr. Garrison and the Debtors, the Debtors' agreement to secure the repayment of the advances with the proceeds of their lawsuit may have been voidable as against public policy, but the court need not reach that issue here. Mr. Garrison has voluntarily withdrawn his claim to be repaid from the proceeds of the lawsuit, and as a result the Debtors are entitled to retain the loans. The loans from Mr. Garrison are distinct from the proceeds of the personal injury suit. The Debtors have properly claimed as exempt \$7,500 of those proceeds, and are entitled to be paid that amount by the Trustee.

While the result in this case appears to create a windfall for the Debtors, such windfall has not come at the expense of their creditors, but rather at the expense of Mr. Garrison. Mr. Garrison voluntarily relinquished his claim to be repaid. Under the court's ruling today, the loss falls on him as it should.

The Debtors have properly claimed their exemption in the proceeds of their personal injury claim and are entitled to be paid \$7,500 from the bankruptcy estate.

ORDER

From all of the foregoing, it is accordingly, ORDERED, that the Debtors' motion to require payment from the bankruptcy estate of their \$7,500 personal injury exemption is GRANTED; the Trustee's objections thereto are OVERRULED; and the Trustee is directed to disburse \$7,500 to the Debtors within fifteen (15) days of the entry of this order.

BY THE COURT:

JENNIE D. LATTA
United States Bankruptcy Judge

Dated: April 24, 1997

cc: Debtors' Attorney
Debtors
U.S. Trustee
Chapter 7 Trustee