

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF IDAHO

In Re:

MANUEL A. LOPEZ, JR. and
JEANETTE LOPEZ,

Debtors.

Bankruptcy Case
No. 03-40205

MEMORANDUM OF DECISION

Appearances:

Kent D. Jensen, Burley, Idaho, Attorney for Debtors.

Jim Spinner, SERVICE, SPINNER & GRAY, Pocatello, Idaho,
Attorney for Chapter 7 Trustee.

R. Sam Hopkins, Pocatello, Idaho, Chapter 7 Trustee.

Debtors object to the Chapter 7 Trustee's Final Report and Accounting because Trustee proposes to disburse the proceeds of Debtors' personal injury settlement recovery to their creditors. Debtors filed an amended Schedule C claiming the \$6,000 personal injury settlement exempt, to which the Trustee objected. An evidentiary hearing concerning these matters was held on

July 27, 2005. The following constitutes the Court's findings of fact and conclusions of law. Fed. R. Bankr. P. 7052; 9014.

Facts

Debtors commenced their Chapter 7 bankruptcy case on February 11, 2003. Docket No. 1. Sam Hopkins was appointed to serve as trustee. In Debtors' original Schedule B, they disclosed an unliquidated claim they held for injuries Ms. Lopez suffered as a result of her use of the diet drug Redux. Schedule B, Docket No. 1. However, no corresponding exemption in any recovery or settlement of the Redux claim was listed on their Schedule C. At that time, Ms. Lopez had undergone an echocardiogram showing damage to her heart from taking Redux, and was awaiting a determination from the pharmaceutical company concerning her right to share in a special settlement fund established to compensate those injured by Redux. Ms. Lopez later received a settlement check on her Redux claim for \$6,000.

Upon learning of these events, on September 1, 2004, Trustee filed a Motion for Turnover of the \$6,000 payment, alleging that the settlement money was property of the bankruptcy estate. Docket No. 17. Debtors did not oppose this motion and turned the settlement money over to the Trustee pursuant to an Order Granting Motion for Turnover issued on October 1, 2004. Docket No. 18.

Debtors testified at the hearing that Debtors had difficulty communicating with their attorney at that time, Mr. Holloway, regarding the handling of the settlement money. On October 6, 2004, Mr. Nielsen substituted as attorney for Debtors. However, the new attorney took no formal steps to obtain the settlement monies on Debtors' behalf.

On April 21, 2005, Trustee filed his proposed Final Report and Accounting. Docket No. 22. In it, Trustee represented that the bankruptcy estate consisted of \$8,365.81, \$6,000 of which was the Redux settlement. Of this amount, Trustee proposed to pay \$2,041.48 in administrative expenses and to distribute the remaining \$6,324.33 pro rata to unsecured creditors. Docket No. 22.

Debtors sought yet another attorney and on May 9, 2005, Mr. Jensen appeared on their behalf. Docket No. 26. That same day, Debtors filed an Objection to Trustee's Final Accounting, Docket No. 27, and amended Schedules B and C. Docket No. 28. The amended Schedule B listed the settlement as cash on hand in the amount of \$6,000. Am. Schedule B, Docket No. 28. On amended Schedule C, Debtors for the first time claimed an exemption in the full amount of the settlement under Idaho Code § 11-604(1)(c).

Trustee filed an objection to Debtor's claim of exemption on May 16, 2005, arguing Debtors are not entitled to the exemption under the statute listed, and furthermore, that the bankruptcy estate was substantially prejudiced by Debtors' delay in claiming the exemption. Docket No. 29. In the alternative, Trustee argued the settlement money is not reasonably necessary for Debtors' support. On June 14, 2005, Debtors responded to Trustee's objection arguing they listed the proper statutory exemption for the settlement and that no prejudice occurred from any delay in filing the exemption claim because Trustee had always been aware of the personal injury claim.

Disposition

A. Amendment of Schedules.

Debtors may amend their schedules, including Schedule C, any time prior to the closing of the bankruptcy case without leave from the court. Fed. R. Bankr. P. 1009(a); *In re Bowden*, 00.3 I.B.C.R. 158, 159 (Bankr. D. Idaho 2000) (citing *In re Michael*, 163 F.3d 526, 529 (9th Cir. 1998)). "However, case law [has] recognized the court may deny a debtor the right to amend exemption schedules where the debtor has acted in bad faith or where the delay in claiming the exemption has prejudiced creditors." *Bowden*, 00.3 I.B.C.R. at 159 (citing *In*

re Michael, 163 F.3d at 529; *In re Arnold* ___ B.R. ___, 2000 WL 1234374 *3 (9th Cir. BAP.); *In re Hamilton*, 93 I.B.C.R. 227, 229 (Bankr. D. Idaho 1993)).

1. Debtors Timely Filed the Amended Schedules.

Debtors filed their amended schedules before their bankruptcy case closed. “Bankruptcy Rule 5009 provides that a Chapter 7 case shall be closed when the trustee has filed a final report, and certifies without objection that the estate has been fully administered.” *In re Michael*, 163 F.3d at 529. Trustee’s final report has not been approved, nor have any disbursements been made from the funds in Trustee’s possession. Therefore, this estate has not been fully administered and Debtors’ amended Schedule C was timely filed.

2. No Prejudice to Creditors Has Been Shown.

Even so, Trustee contends that Debtors’ delay in claiming the exemption in the Redux recovery prejudiced creditors because, if allowed, those creditors will not receive the distribution reflected in the Final Accounting. “The mere fact that allowance of the amendment would remove assets from administration is, standing alone, insufficient to establish prejudice.” *In re Hoffpauir*, 258 B.R. 447, 452 (Bankr. D. Idaho 2001) (citing *In re Arnold*, 252 B.R. 778, 784 (9th Cir. BAP 2000)). In order to constitute prejudice for these purposes, a creditor must “suffer an actual economic loss due to a debtor’s delay

in claiming his exemption.” *Arnold*, 252 B.R. at 787. Trustee has not shown how any creditors in this case have suffered any economic loss as a result of Debtors’ recent exemption claim.

3. No Prejudice to Trustee Was Shown.

“‘Merely showing prejudice’ does not automatically trigger disallowance of an amendment: the court must balance the prejudice to the debtor of disallowing the exemption against the prejudice to third parties in allowing the exemption.” *Id.* at 785. In *In re Boyer*, 7 B.R. 930, 932 (Bankr. D. Idaho 1981), the Court examined several cases wherein debtors claimed property exempt only after the trustee took action to administer the property. In each of those cases, the trustee argued the newly claimed exemption was prejudicial because the trustee would not receive a fee if the exemptions were allowed. *Id.* While agreeing that the amendments prejudiced the trustee the Court reasoned that,

to deny an exemption by reason of this prejudice may be inequitable in many instances. . . . The failure to claim exemptions in my experience is generally the result of negligence, mistake, or lack of knowledge of bankruptcy procedure by the debtor’s attorney. The debtor himself should not be penalized for this.

I thus conclude that the Court should exercise its equitable powers in these instances and allow an amendment to exemptions when the exemption was not claimed by reason of excusable neglect, but that its allowance should be conditioned upon payment from

sources other than the exempt property to the trustee for any out-of-pocket costs to him by reason of the late claim of exemption.

Id.

Here, Debtors argue they attempted to work out the issue of their entitlement to the settlement money with Trustee, and that it was Debtors' attorneys who delayed filing the claim of exemption. They point out that the same day Debtors' current attorney appeared in the case, they filed their amended schedules with the claimed exemption. Debtors argue these facts show their failure to file the exemption claim earlier was excusable neglect.

Debtors have made an adequate showing of excusable neglect. As in *Boyer*, the amendment to their exemption schedule should be allowed. Any prejudice suffered by Trustee can be remedied by reimbursement to the estate and Trustee for any expenses incurred prior to the filing of the amended exemption claim.

4. No Reliance on the Settlement Money Shown.

This Court has also found prejudice when the debtor waited to exempt a recovery from a legal action until after the bankruptcy trustee had negotiated a settlement, and submitted that settlement to the Court for approval. In *In re Hamilton*, 93 I.B.C.R. 227, 229 (Bankr. D. Idaho 1993), the trustee

negotiated to settle an action against a third party because it had not been exempted by the debtor. *Id.* When trustee proposed the settlement for approval by the Court, the debtor attempted to exempt the recovery. The Court concluded under those facts that debtor's conduct was prejudicial and that she should have exempted the lawsuit prior to the trustee reaching a compromise to settle the case. *Id.*

Authority from the Ninth Circuit Bankruptcy Appellate Panel suggests debtors should be allowed to amend their schedules to claim an exemption even after the trustee negotiates a settlement in the absence of reliance by creditors. In *In re Arnold*, the debtors were allowed to amend their schedules to claim an exemption in a \$200,000 settlement the trustee negotiated. *In re Arnold*, 252 B.R. 778, 781 (9th Cir. BAP 2000). The trustee objected, claiming that the late amendment prejudiced the creditors by defeating their expectation regarding the amount of the payout. But, the Panel reasoned that to show the kind of prejudice necessary to deny the amended exemption claim, there must be evidence to "indicate that any creditor would have acted differently had it known of the full extent of the . . . claimed exemptions." *Id.* at 787–88.

Here, Trustee did not negotiate the settlement of Debtors' Redux claim, nor did he rely on the fact that the negotiated settlement would be a part of

the bankruptcy estate. Trustee's efforts in this case consisted of filing the Motion for Turnover, which was unopposed, and with which Debtors complied. This is a markedly different situation from the trustee who undertook the effort and incurred the expense to negotiate a settlement with the third party in *Hamilton*. While ideally Debtors' amended schedule C should have been filed earlier, any expense incurred by Trustee in pursuing turn over of the settlement funds can be reimbursed such that Debtors' exemption claim should not be denied solely because of their delay in asserting it.

B. The Redux Settlement is Exempt.

Idaho has accepted the Code's invitation to restrict its citizens to the exemptions allowed under state law. 11 U.S.C. § 522(b)(1); Idaho Code § 11-609.

As the objecting party Trustee bears the burden of proof to show the exemption is not proper. Fed. R. Bankr. P. 4003(c). However, once Trustee presents "sufficient evidence to rebut the prima facie validity of the exemption, the burden shifts to a debtor to demonstrate that the exemption is proper." *In re Nielsen*, 97.4 I.B.C.R. 107, 107 (Bankr. D. Idaho 1997) (citing Russell, BANKRUPTCY EVIDENCE MANUAL, 1997 Ed., page 323; *In re Frazier*, 104 B.R. 255 (Bankr. N.D. Cal. 1989)). Additionally, "it is well-established that the nature and extent of exemptions is determined as of the date that the bankruptcy petition is filed." *In re*

Moore, 269 B.R. 864, 868 (Bankr. D. Idaho 2001) (citing *Culver, LLC v. Chiu (In re Chiu)*, 266 B.R. 743, 751 (9th Cir. BAP 2001)). Moreover, exemption statutes are liberally construed in favor of the debtor. *In re Steinmetz*, 01.1 I.B.C.R. 28, 28 (Bankr. D. Idaho 2001).

1. The Redux Settlement Money Can Be Exempted Under Idaho Code § 11-604(c)(1).

Debtors claim an exemption in the settlement funds under Idaho Code § 11-604(1)(c), which provides:

An individual is entitled to exemption of the following property to the extent reasonably necessary for the support of him and his dependants . . .

(c) proceeds of insurance, a judgment, or a settlement, or other rights accruing as a result of bodily injury of the individual or of the wrongful death or bodily injury of another individual of whom the individual was or is a dependent.

Idaho Code § 11-604(1)(c). Trustee objected, arguing Debtors failed to specify the law providing the exemption and are otherwise not entitled to the exemption under the statute listed. Docket No. 29. On amended Schedule C Debtors specified the law providing the exemption as Idaho Code § 11-604(1)(c). This code section, in part, exempts from administration by the estate proceeds of a settlement for bodily injury. The \$6,000 claimed as exempt resulted from a class

action settlement from which Ms. Lopez was entitled to compensation due to heart damage she sustained. Such funds are clearly eligible for exemption under Idaho Code § 11-604(1)(c) as Debtors claim.

2. The Settlement Proceeds are Reasonably Necessary for Debtors' Support.

Idaho Code § 11-604(2) defines the phrase “property to the extent reasonably necessary for the support of him and his dependents” as that “required to meet the present and anticipated needs of the [debtor] and his dependents, as determined by the court after consideration of the [debtor's] responsibilities and all the present and anticipated property and income of the [debtor], including that which is exempt.” Trustee argues that the settlement money is not necessary for Debtors' support. The Court disagrees.

Normally, the Court looks to the date of the filing of the petition to determine the extent of an exemption. But in this instance, the exemption statute requires the Court to consider the Debtors' “present and anticipated needs.” In doing so, does the Court examine Debtors' needs as of the date they filed their petition? Must the Court consider Debtors' needs as of the date they claimed the exemption? Or should the Court instead consider Debtors' present and anticipated needs as of the date the evidentiary hearing was held?

“The cardinal rule of statutory construction [is] the plain meaning of a statute controls, except in rare cases where a literal interpretation produces absurd results.” *In re Proalert, LLC*, 314 B.R. 436, 441 (9th Cir. BAP 2004) (citing *In re Transcon Lines*, 58 F.3d 1432, 1437 (9th Cir. 1995)). While the statute requires the Court to consider Debtors’ present needs, bankruptcy law requires the Court to determine the extent of exemptions as of the petition date. “The right to exemptions under the Bankruptcy Code, like the Bankruptcy Act, is generally *determined by facts as they existed on the date bankruptcy was filed.*” *In re Kim*, 257 B.R. 680, 686 (9th Cir. BAP 2000), *aff’d*, 35 Fed.Appx. 592 (9th Cir. May 23, 2002) (citing *Arkinson v. Gitts (In re Gitts)*, 116 B.R. 174 (9th Cir. BAP 1990)); *See also In re Yackley*, 03.1 I.B.C.R. 84, 84 (Bankr. D. Idaho 2003).

The Court concludes that it should read Idaho Code § 11-604(2) in conjunction with the bankruptcy case law such that “present and anticipated needs” refers to those existing as of the petition date. To decide otherwise would create a constantly moving target. As the Bankruptcy Appellate Panel has observed, taking into account post-petition events to determine exemptions “would wreak havoc with the uniformity of bankruptcy law and procedure, and would permit an unending opportunity for creditors and debtors to examine and contest post-petition actions of a Chapter 7 debtor.” *In re Kim*, 257 B.R. at 288.

If the Court looked to the time the exemption claim was filed or amended, it could create an incentive for debtors to delay claiming exemptions as long as possible, with the hope of being able to present a more compelling case to the bankruptcy court after filing the petition.

At the time the petition was filed, Debtors' monthly income was \$2,630.00 with monthly expenses of \$2,563.00. This left Debtors with a monthly disposable income of \$67.00. When they filed for bankruptcy, Debtors were aware that Ms. Lopez's Redux use had damaged her heart and that she was entitled to some amount of money from the settlement fund. Debtors also knew that Ms. Lopez would need additional echocardiograms in the future to determine if her condition was worsening. Each echocardiogram costs approximately \$1,000, and Ms. Lopez's doctors recommend that she have the test every two to three years. During the hearing Ms. Lopez testified she has health insurance that will pay 80% of her medical costs, but only after she meets the yearly \$3,000 family deductible.

Under the Redux settlement program, if Ms. Lopez's condition substantially worsens prior to December 31, 2015, she can apply for additional compensation from the fund. As a result, Ms. Lopez can reasonably expect to have an echocardiogram every other year, at least through 2015. Because

Debtors' medical insurance has such a large deductible, the Court is persuaded it should anticipate that Debtors will be required to pay for each echocardiogram. At the time of filing, Debtors' disposable income of \$67.00 was insufficient to cover the cost of the needed echocardiograms, even if the medical insurance deductible is met. Since Ms. Lopez is only eligible for additional compensation if the damage to her heart worsens, and an echocardiogram is required to determine whether her condition is worsening, Ms. Lopez must be able to pay for these additional tests.

Given these facts, the Court finds that the \$6,000 settlement money was reasonably necessary for the support of Mrs. Lopez and her family as of the date of the filing of her bankruptcy petition.

Conclusion

Trustee's objection to Debtors' amended claim of exemption as to the \$6,000 Redux settlement is overruled. Trustee did not show that the bankruptcy estate or creditors would be sufficiently prejudiced to deny the exemption because of Debtors' delay in asserting the exemption claim. The settlement money is covered by the Idaho exemption statute and is reasonably necessary for the support of Mrs. Lopez. Debtors' objection to Trustee's Final

Report and Accounting wherein he proposes to distribute the settlement money to creditors is sustained.

If Trustee can demonstrate that the bankruptcy estate has incurred any costs or expenses directly associated with Debtors' delay in claiming the settlement funds exempt, such as any costs associated with preparing, filing and serving his initial accounting, then after appropriate motion, notice and a hearing, the Court will allow Trustee to deduct those expenses from the settlement funds. In the meantime, the balance of the funds in excess of any of those allowed costs should be returned to Debtors.

A separate order will be entered.

Dated: September 18, 2005



Honorable Jim D. Pappas
United States Bankruptcy Judge

