UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

In Re. PAUL AN, Debtor.	Chapter 7 Case No.: 05-38083 (DHS) Hearing Date: September 4, 2007 @ 10:00 a.m.

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MEMORANDUM OF LAW IN OPPOSITION TO THE CHAPTER 7 TRUSTEE'S MOTION OBJECTING TO DEBTOR'S AMENDED EXEMPTION IN INTEREST IN PERSONAL INJURY ACTION

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On the Brief:
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PRELIMINARY & FACTUAL STATEMENT

In addition to this Memorandum of Law, the Debtor relies upon the Certification of Glenn R. Reiser ("Reiser Cert.") and Certification of Paul An submitted herewith. Each of these Certifications is incorporated by reference herein. While Debtor's counsel has the utmost respect for the Chapter 7 Trustee, it is plainly unreasonable for him to be taking the position that the Debtor is not entitled to receive a single dime from his personal injury settlement simply because the claim was valued at zero on the Debtor's initial Schedules B and C of his bankruptcy petition. At the time the bankruptcy case was filed, the personal injury claim was in its infancy and thus there was no dollar value that the Debtor (or "Mr. An") could assign to the claim. In point of fact, the Chapter 7 Trustee never objected to Mr. An's initial claimed exemption under *Section 522(d)(11)(D),* closed the case out, and then reopened the case more than a year later to pursue, what Mr. An and his counsel believed, a discrimination claim that the Debtor testified about at the creditors' meeting.

The personal injury claim became liquidated post-petition in the amount of $40,000. At no time during the reopening of the bankruptcy case did the Chapter 7 Trustee's counsel communicate to Mr. An's counsel their client's intention to administer the personal injury claim or that they were taking the position that Mr. An is not entitled to an exemption simply because the claim was initially valued at zero. As soon as Mr. An's counsel became aware of the personal injury settlement, he promptly communicated to the Chapter 7 Trustee's counsel that this claim was exempt. Upon learning of the Chapter 7 Trustee's adverse position, Mr. An promptly amended his exemptions to incorporate the liquidated dollar value of his exemption under *Section 522(d)(11)(D)* and also to include a wildcard exemption under *Section 522(d)(5)*. To the extent that the Chapter 7 Trustee unilaterally decided to administer the

personal injury claim without properly objecting to the Debtor's initial exemption or providing proper notice of such intention to Mr. An and his bankruptcy counsel, he acted at his own peril. Further, to the extent the Trustee is claiming detrimental reliance such a claim is not supported by the Trustee's actions over the course of this case. It is simply unreasonable for the Trustee to believe that Mr. An would simply walk way from his personal injury claim altogether. To the contrary, Mr. An has certified that the proceeds of this personal injury settlement are critical to his ability to earn a fresh start.

LEGAL ARGUMENT

THE CHAPTER 7 TRUSTEE HAS NOT MET HIS BURDEN OF PROOF TO DISALLOW THE DEBTOR'S CLAIMED EXEMPTIONS IN THE PERSONAL INJURY SETTLEMENT PURSUANT TO BANKRUPTCY RULE 4003

The Chapter 7 Trustee, as the objecting party, bears both the initial burden of production and ultimate burden of persuasion in any controversy regarding legitimacy of the Debtor's claimed exemptions. *Fed. R. Bankr. P. 4003(c).* The Chapter 7 Trustee must produce evidence to rebut the presumptive validity of Debtor's claimed exemptions by a preponderance of the evidence. *In re Scotti*, 245 B.R. 17, 20 (Bankr. D.N.J. 2000) (A trustee must show by a preponderance of the evidence that the Debtor is improperly claiming the proceeds of the personal injury settlement). Only if the Chapter 7 Trustee produces evidence to rebut presumptive validity of Debtor's claimed exemptions does the burden of production shift to the Debtor to come forward with sufficient evidence to demonstrate that exemption is proper. *In re Reschik*, 343 B.R. 151 (Bankr. W.D.Pa. 151 2006). As demonstrated by the facts of this particular case, the Trustee has not met his burden.

A. The Net Personal Injury Settlement Proceeds Are Fully Exempt Because The Chapter 7 Trustee Did Not Timely Object to the Initial Claimed Exemption Pursuant to Bankruptcy Rule 4003

The procedure to object to a debtor's claimed exemption is set forth in *Fed. R. Bankr. P. 4003*. Pursuant to subsection (b) of the Rule:

> A party in interest may file an objection to the list of property claimed as exempt only within 30 days after the meeting of creditors held under § 341(a) is concluded or within 30 days after any amendment to the list or supplemental schedules is filed, whichever is later. The court may, for cause, extend the time for filing objections if, before the time to object expires, a party in interest files a request for an extension. Copies of the objections shall be delivered or mailed to the trustee, the person filing the list, and the attorney for that person.

Ibid. "Absent a timely filed objection, the property claimed by a debtor as exempt under section 522 of the Bankruptcy Code is exempt." *Taylor v. Freeland & Kronz*, 938 F2d. 420 (3rd Cir. 1991).

The *Taylor* decision is particularly on point and unquestionably supports the Debtor's position. In *Taylor* the debtor listed a discrimination claim against her former employer in Schedule B of her bankruptcy petition with an "unknown" value. The "unknown" value of this claim was repeated as an exemption on Schedule C of her petition. Several years prior to the settlement of the claim, the trustee sent a letter to the debtor's personal injury lawyers asserting that the claim was property of the bankruptcy estate. However, neither the trustee nor any other party in interest ever filed an objection to the Debtor's claimed "unknown" exemption in the claim. The injury claim subsequently settled for $110,000, and the funds were distributed post-petition. Upon learning of the settlement, the trustee filed suit to avoid the post-petition transfers and to recover the settlement proceeds as property of the bankruptcy estate. In reversing the lower courts' decisions, the Third Circuit ruled in the debtor's favor, concluding

that in the absence of "a timely filed objection, the property claimed by a debtor as exempt under section 522 of the Bankruptcy Code is exempt." *Id.* at 426.

Pursuant to *11 U.S.C. § 522(l)*, "[T]he debtor shall file a list of property that the debtor claims as exempt under subsection (b) of this section…*Unless a party in interest objects, the property claimed as exempt on such list is exempt*." *Ibid*. (Emphasis added). In the case at bar, the Debtor properly disclosed the personal injury claim in Schedules B and C of his originally filed bankruptcy petition. Schedule B sets forth an interest in the proceeds of an inchoate personal injury action with an unknown value. The value was unknown because, as set forth in the Reiser Cert submitted herewith, "…the extent of the Debtor's injuries had yet to be determined and the claim was in its infancy." Reiser Cert., at ¶ 5. The claim was therefore valued at $0.00 on Schedule B, and because of the mechanics of the bankruptcy software that value was then repeated on Schedule C. The Trustee failed to object to this exemption, and in fact proceed to close out the case. Under these circumstances, it was certainly reasonable for the Debtor to conclude that the Trustee had abandoned any claim to his personal injury case. The same expectations of the Debtor continued even when the Trustee petitioned to reopen the case, for the Debtor believed that the Trustee was intent on pursuing a separate discrimination claim that the Debtor had testified about at the initial creditors' meeting.

The Trustee raised no objection to the exemption at the time the petition was filed, nor did he do so in the course of the 341(a) meeting or within 30 days thereafter as required by *Fed. R. Bankr. P. 4003(b)*.[1] Instead, the Chapter 7 Trustee issued his Report of No

[1] It is of no consequence that the Trustee has objected to Mr. An's amended exemptions within 30 days of the filing of the amendments under Bankruptcy Rule 4003, because the Trustee effectively abandoned the claim to begin with by taking no action to object to the original claimed exemption and by initially closing the case. Pursuant to Section 554(c), "[U]nless the court orders otherwise, any property scheduled under section 521(1) of this title not otherwise admiistered at the time of the closing of a case is abandoned to the debtor and administered for the purpose of section 350 of this title." *Ibid.*

Distribution on November 8, 2005, the Debtor was discharged December 16, 2005 and a Final Decree was issued on December 19, 2005. The Chapter 7 Trustee took no further action until late June 2006 when he moved to reopen the case and vacate the Final Decree.

The rationale for the Trustee's motion to reopen the case was set forth in paragraphs 7 and 10 of the *Certification of Charles M. Forman in Support of Motion for an Order Vacating [the] Final Decree*: "At the meeting of creditors, I elicited testimony from the Debtor which leads me to believe that [*sic*] estate may have claims against various parties, including certain public officials, in connection with the cessation of the Businesses. In addition, testimony provided by the Debtor indicates that the Personal Injury Claim may have value." *Id.* Nothing in the Trustee's motion to reopen remotely suggested that he intended to object to the Debtor's claimed exemption in the proceeds of the personal injury case. The fact that the Trustee thought the personal injury claim "may have value" did not substitute as a formal objection to the Debtor's claimed exemption in this asset. In other words, the Trustee did not put the Debtor or his counsel on notice that he believed the claim to have a value that exceeded the Debtor's claimed exemptions.

In sum, all of the Trustee's actions reflected his acceptance of the Debtor's exemption, and none of the steps he took caused the Debtor or his bankruptcy counsel to believe that he intended to contest the scheduled exemption. Under these circumstances, the Trustee is unable to satisfy his burden of persuasion under *Fed. R. Bankr. P. 4003(b).* Accordingly, the Court should deny the Trustee's motion. A ruling to the contrary would completely prejudice Mr. An's ability to enjoy a fresh start, which is one of the paramount objectives afforded by the Bankruptcy Code to honest debtors such as Mr. An.

B. The Debtor's Amended Exemptions Are Allowable Pursuant to Bankruptcy Rule 1009.

There was no reason for the Debtor to amend his claimed exemptions until the personal injury claim became liquidated. As soon as the Debtor's bankruptcy counsel became aware of the liquidated value of this claim, the schedules were promptly amended including the Debtor's assertion of the wildcard exemption.

A debtor is permitted to amend a voluntary petition "as a matter of course, at any time before the case is closed." *Fed. R. Bankr. P. 1009(a).* According to the Third Circuit Court of Appeals' analysis of the precursor to *Fed. R. Bankr. P. 1009(a),* Rule 110, the rule change effected in the latter and repeated verbatim in 1009(a) removed the debtor's ability to amend the petition from the discretionary review of a Bankruptcy Court: "When the bankrupt files an application to amend a voluntary petition in bankruptcy, the court's only role under Rule 110 is to decide who should be given notice of the amendment." *Matter of Gershenbaum,* 598 F. 2d 779, 780 (3rd Cir. 1979).

In *Scotti, supra,* Judge Tuohey rejected a Chapter 7 trustee's objection to the debtor's wildcard exemption under *Section 522(d)(5),* which the debtor asserted by way of amendment to Schedule C after his personal injury action became liquidated during the course of the bankruptcy case.

> The Trustee argues that the Debtor should not be allowed to amend his exemptions simply because his medical malpractice claim has bore fruit, while his breach of contract claim continues in litigation. The Trustee asserts that this is unfair to the general unsecured creditors. The Bankruptcy Code and case law dictate otherwise. First, Rule 1009(a), Federal Rules of Bankruptcy Procedure, permits the debtor to amend his schedules at any time before the case is closed. Moreover, courts have held that exemptions are one-time benefits conferred upon the debtor by statute and, only once used to the full amount possible they are of no further benefit to the debtor. *See United States v. Christensen,* 200 B.R. 869, 872

(D.S.D.1996); *In the Matter of Baugh*, 15 B.R. 435, 436 (Bankr.W.D.Mo.1981).

Scotti, 245 B.R. at 22. (Emphasis in original). *See also In re Daly*, 344 B.R. 304, 321 (Bankr. M.D.Pa. 2005)(court held "that in those instances where Debtor's exemption schedules reflect an exemption amount equal to the property's listed value amount, he has attempted to exempt 100% of his property interest regardless of the property's ultimate valuation amount.").

The cases cited in the Trustee's supporting brief are inapposite and unpersuasive. For example, in *In re Cudeyro*, 213 B.R. 910 (Bankr. E.D.Pa. 1997), the debtor amended her petition for a second time to assert an exemption to proceeds of a personal injury claim *after* entering into a settlement with the Trustee and *after* receiving a distribution in the agreed-upon amount. The prejudice to the trustee in *Cudeyro* – who was relying on a settlement – was clearly recognizable and substantial…but those circumstances are completely unrelated to the case at bar where the Debtor scheduled the property and the exemption, and it was the Trustee's Report of No Distribution that the Debtor, in complete good faith, relied upon.

The Trustee's reliance on *In re Lockovich*, 150 B.R. 989 (Bankr. W.D. Pa. 1993), is also misplaced. In that case, the bankruptcy estate incurred administrative expenses during the Chapter 11 that was subsequently converted to a Chapter 7. The Debtors sought to amend their exemptions in the proceeds from the sale of their home, with the result that some $250,000.00 in Chapter 11 administrative expenses would be unpaid. The Court granted their motion to amend conditioned on the debtors agreement to waive discharge of the administrative expenses. Since the administrative expenses in *Lockovich* were the consequence of the Debtors' choice to file a Chapter 11, that case is inapposite to the case at bar. By contrast, whatever expenses the Trustee incurred in this case are the result of his unilateral actions, not choices made by Mr. An.

Another case cited in the Trustee's brief, *In re Kobaly*, 142 B.R. 743 (Bankr. W.D.Pa. 1992), actually supports the Debtor's position by confirming that a debtor has the right to amend his petition at any time before the case is closed pursuant to *Fed. R. Bankr. P. 1009*. In *Kobaly*, the debtor sought to exempt the entire proceeds of an eminent domain award for $162,000.00 on the premise that it represented compensation for lost wages. The court rejected this argument, opining that the debtor's interest was a property interest and the exemption was therefore limited by and rightfully taken as his wildcard exemption, since he previously exhausted his real property exemption when the property was sold. Referring approvingly to the Third Circuit's ruling in *Gershenbaum*, *supra*, the *Kobaly* Court recited *Bankruptcy Rule 1009* as giving the Debtor the right to amend a voluntary petition as a matter of course before the case is closed. *142 B.R.* at 748.

Finally, *In re Shaffer*, 92 BR 632 (Bankr. E.D. Pa. 1988) does not support the Trustee's cause. First, *Shaffer* was a Chapter 11 case. The debtors scheduled their equity interest in their personal residence and asserted their homestead exemption. The property was sold, and at the debtors' request the Court authorized the distribution of the exempt proceeds to the debtors. Roughly $50,000.00 in sale proceeds remained in the estate after payment of the mortgage and the distribution of the debtors' exemptions. The debtors then sought to reclassify claims in their Chapter 11 case into those that were joint and those that were against only one of them. A creditor filed an adversary proceeding, arguing that the change in exemptions would reduce his claim from a substantial portion of the remaining proceeds of about $50,000.00 to nothing. The court agreed, and found that because the debtors received a distribution prior to their effort to amend their exemptions from the federal to the state scheme – a sea change – the amendment would not be permitted.

In contrast to the above cases cited by the Trustee, Mr. An both disclosed his property interest in the proceeds of the personal injury case and asserted his exemption on his original petition. None of his creditors placed any reliance upon any action or any failure to act by Mr. An, and no one objected to his claimed exemption pursuant to *Fed. R. Bankr. P. 4003*. It was wholly unreasonable of the Trustee to assume that because the exemption was accurately set down on Schedule C with a value of $0.00 when the case was filed that the Debtor intended to abandon the proceeds. Accordingly, the Trustee's motion should be denied.

C. The Court Should Apply Section 105(a) of the Bankruptcy Code To Avoid Any Inequitable Result to the Debtor

Mr. An urges this Court, as a court of equity, to apply *Section 105(a)* of the Bankruptcy Code to protect his entitlement to the exemptions asserted over his personal injury claim settlement. Pursuant to *Section 105(a)* of the Bankruptcy Code,

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

11 U.S.C. §105(a). The Third Circuit Court of Appeals has extensively commented on the application of *Section 105(a)* of the Bankruptcy Code. *See e.g., In re Joubert*, 411 F.3d 452 (3rd Cir. 2005), citing *In re Continental Airlines*, 203 F.3d 203 (3rd Cir. 2000); *In re International Power Securities Corp.*, 170 F.2d 399, 402 (3rd Cir. 1948)(recognizing Bankruptcy Court's injunctive powers to protect the property and assets of a bankrupt wherever situated).

In *Joubert*, The Third Circuit offered the following analysis of its prior interpretations of Section 105(a):

> In *In re Continental Airlines*, 203 F.3d 203 (3d Cir.2000), we observed that § 105(a) "supplements courts' specifically enumerated bankruptcy powers by authorizing orders necessary or appropriate to carry out provisions of the Bankruptcy Code." *Id.* at 211. We cautioned that § 105(a) "has a limited scope. It does not 'create substantive rights that would otherwise be unavailable under the Bankruptcy Code.' " *Id.* (quoting *United States v. Pepperman*, 976 F.2d 123, 131 (3d Cir.1992)). This instruction was consistent with our earlier observation in *In re Morristown & Erie Railroad Co.*, 885 F.2d 98 (3d Cir.1990), that § 105(a) authorize[s] the bankruptcy court, or the district court sitting in bankruptcy, to fashion such orders as are required to further the substantive provisions of the Code. Section 105(a) gives the court general equitable powers, but only insofar as those powers are applied in a manner consistent with the Code. Nor does Section 105(a) give the court the power to create substantive rights that would otherwise be unavailable under the Code. *Id.* at 100 (citations omitted).
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> *Morristown* reveals this Court's considered view that § 105(a) is a powerful, versatile tool, but that it operates only within the context of bankruptcy proceedings. Section 105(a) empowers bankruptcy courts and district courts sitting in bankruptcy to fashion orders in furtherance of Bankruptcy Code provisions.

Joubert, 411 F.3d at 455.

Protecting Mr. An's exemptions in the proceeds of his personal injury settlement by application of Section 105(a) would certainly be consistent with other substantive rights afforded to debtors under the Bankruptcy Code, in particular Section 522(d)(11)(D) and Section 522 (d)(5), as well as advancing the "fresh start" concept afforded to honest debtors such as Mr. An.

CONCLUSION

The Chapter 7 Trustee has not met his burden of proof under *Fed. R. Bankr. P. 4003(b)* to disallow Mr. An's claimed exemptions in the proceeds of his personal injury lawsuit. Mr. An's receipt of the exempted portion of settlement proceeds is critical to his ability to obtain a fresh start. It would be entirely inequitable and prejudicial to the Debtor if the Court were to

disallow Mr. An's exemptions in the personal injury suit. Mr. An truthfully disclosed the asset and when it became liquidated, and properly amended his exemptions to reflect the liquidated value of the claim and his entitlement to assert all statutory exemptions permitted by the Bankruptcy Code. Therefore, the Trustee's motion should be denied.

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Attorneys for Debtor

Dated: August 17, 2007

/s/ Glenn R. Reiser
Glenn R. Reiser