

CONSUMER BANKRUPTCY

Loss of Future Earnings Federal Bankruptcy Exemption

Second Circuit decision emphasizes forward-looking approach

By Craig D. Robins

Bankruptcy exemptions have been receiving a great deal of attention here in New York lately because of the recent dramatic changes to our state's exemption statutes. These changes include giving debtors the option of using either the federal or New York State exemptions.

It is therefore an ideal time to discuss a recent, interesting Second Circuit decision involving a Connecticut bankruptcy case that addresses the federal exemption for protecting entitlement to a claim for lost post-petition earnings.

Debtors had a claim for Wrongful Termination

In *Jackson v Novak*, 593 F.3d 171 (2d Cir. 2010), the husband and wife debtors, who were a psychiatrist and a psychologist, filed a typical Chapter 7 consumer bankruptcy petition in which they sought to discharge typical consumer debt. One of the assets that they sought to exempt consisted of the proceeds of a settlement for wrongful discharge.

Prior to filing, both debtors had been employed by a health insurance company in Connecticut. The company closed the local office and terminated the debtors' employment about six months pre-petition. Also prior to filing, the debtors asserted claims against the company for wrongful termination, alleging they were fired in retaliation for challenging the way certain health insurance claims were treated.

In October 2003, the debtors filed their Chapter 7 bankruptcy petition, list-

ing the cause of action for wrongful termination. Thereafter, the Chapter 7 trustee pursued the claims against the former employer and reached a settlement of \$130,000 about a year after the bankruptcy was filed.

The settlement was "to satisfy claims for future lost earnings." After attorney's fees and expenses, the net proceeds to the debtors amounted to \$83,000. In essence, the settlement essentially bought out the debtor-husband's contract, paying him an amount equal to one year's worth of salary. The debtor had stood to earn half of this amount prior to the time the bankruptcy was filed, and the other half, after the bankruptcy was filed.

Debtors and trustee litigate over exempting proceeds from claim

The debtors sought to exempt the settlement proceeds by amending their schedule of exemptions, stating that under Bankruptcy Code § 522 (d)(11)(E), which is one of the federal exemption provisions, these proceeds were exempt.

This section of the federal exemptions permits a debtor to exclude from the bankruptcy estate "a payment in compensation of loss of future earnings of the debtor to the extent reasonably necessary for the support of the debtor and any dependent of the debtor."

The trustee objected, arguing that the proceeds were not exempt under several different theories, and the matter landed before the bankruptcy court judge who held a trial.



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Bankruptcy Court utilizes forward-looking approach

The court noted that the debtor's schedules indicated monthly income of \$10,000 and monthly expenses of \$14,000, a monthly shortfall of \$4,000. In addition, the court also noted that debtors retained post-petition, \$6,200

in cash, and a boat and trailer; they had the use of four vehicles; they lived in a \$435,000 house; they owned a one-third interest in 20 acres of land in Tennessee; and both debtors were working "without any mental or physical disabilities or restrictions."

The bankruptcy court concluded that given the language of § 522(d)(11)(E), only earnings related to the period after the filing of the bankruptcy petition could be exempted. Property of the estate and a debtor's exemption therein, is determined as of the bankruptcy petition date. Section 522(d)(11)(E) refers only to post-petition loss of earnings, and the debtor may not exempt that portion of the settlement proceeds that provided compensation of his pre-petition loss of earnings.

In other words, the debtor was only able to protect that compensation which he stood to earn after the petition was filed. However, the court did not stop there. The statute states that debtors can only exempt such payments "to the extent reasonably necessary for the support of the debtor and any dependent of the debtor."

Accordingly, the court conducted a computational analysis. Basically, since

the debtors had a monthly shortfall of \$4,000 a month, the court let the debtors keep that sum for the period of the settlement that covered the post-petition period. That amount was \$16,550.

The debtors, who had hoped for much more, appealed to both the District Court and the Second Circuit Court of Appeals, arguing that the bankruptcy court had improperly calculated the amount. Both appellate courts affirmed the decision of the bankruptcy court.

The Second Circuit emphasized that the provisions of § 522(d)(11)(E) apply only to post-petition earnings and defined the term "future" as "looking forward from the date of the bankruptcy filing" and not from some previous point in time, as the debtors had argued.

The Court of Appeals found no error in the lower courts' reasoning that considered such factors as the debtors' needs, including present and anticipated expenses, their assets, present and anticipated income, training and education, and "ability to earn a living" in arriving at the \$16,550 figure that represented a shortfall in their income.

Note: Craig D. Robins, Esq., a regular columnist, is a Long Island bankruptcy lawyer who has represented thousands of consumer and business clients during the past twenty years. He has offices in Coram, Mastic, West Babylon, Patchogue, Commack, Woodbury and Valley Stream. (516) 496-0800. He can be reached at CraigR@CraigRobinsLaw.com. Please visit his Bankruptcy Website: www.BankruptcyCanHelp.com and his Bankruptcy Blog: www.LongIslandBankruptcyBlog.com.