

# LEVYING FLESH AND CHARGING SOCIETY, CREDITORS, AND INSURANCE COMPANIES FOR IT: THE IRONY OF INCLUDING PERSONAL INJURY AWARDS IN THE BANKRUPTCY ESTATE

## INTRODUCTION

### A. *A Pound of Flesh*

“If you repay me not on such a day . . . [a pound] [o]f your fair flesh [will] be cut off and taken . . . .”<sup>1</sup> With those words, a Shakespearean creditor agreed to extend a loan on the promise of a pound of flesh from the breast of the guarantor if no one made repayment within three months.<sup>2</sup> The peculiar agreement seemed odd to the townspeople; for what could a creditor possibly use a pound of flesh?<sup>3</sup> Regardless, the overzealous creditor persisted in satisfying his debt by the means prescribed.<sup>4</sup> When the creditor sought to collect the flesh of the debtor, the judge ruled that the creditor indeed had an interest in the pound of flesh.<sup>5</sup> However, there was no way to precisely excise a pound of flesh from the body of the debtor without bloodshed.<sup>6</sup> Therefore, the creditor could not foreclose on the collateral because, by the agreement, he was entitled only to a pound of flesh and no more.<sup>7</sup>

It is axiomatic that a creditor cannot take a pound of flesh from the debtor to satisfy a debt. However, with limited exception, awards for personal injury are included in the bankruptcy estate in their entirety and given only limited exemption status.<sup>8</sup> As such, an award meant to compensate the debtor for actual physical loss is given to creditors. This is akin to allowing a creditor to take a pound of the debtor’s flesh.

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<sup>1</sup> WILLIAM SHAKESPEARE, *MERCHANT OF VENICE* act 1, scene 3.

<sup>2</sup> *Id.*

<sup>3</sup> An observer remarked: “[T]hou wilt not take his flesh: what’s that good for?” *Id.* at act 3, scene 1.

<sup>4</sup> *See id.*

<sup>5</sup> *See id.* at act 4, scene 1.

<sup>6</sup> *See id.*

<sup>7</sup> *See id.*

<sup>8</sup> *See, e.g.*, 11 U.S.C.A. § 522(d)(11)(D) (West 2005) (exempting up to \$18,450 of a personal injury recovery).

*B. Bankruptcy and the Social and Personal Costs of Injury*

Nearly 45.8 million Americans do not have health insurance.<sup>9</sup> The cost of an accidental injury ranges from \$6800 to \$193,800, depending on its locus of occurrence, duration, and severity.<sup>10</sup> Costs of injuries include actual physical loss, lost earnings, medical expenses, and mental suffering.<sup>11</sup> Thus, the uninsured victim of a tort causing personal injury needs as much financial assistance as possible. Financial support for the injured tort victims, especially those without insurance, comes in the form of a monetary recovery intended to replace their losses.<sup>12</sup> Such awards often compensate for the actual loss of flesh and blood by the victim. Thus, a monetary award is figurative flesh to the injured tort victim. However, bankruptcy claims the personal injury recoveries of over 1.5 million Americans each year to repay hungry creditors.<sup>13</sup> Thus, through bankruptcy creditors levy the flesh of debtors who have received personal injury recoveries. The irony is that in nearly forty-seven percent of the bankruptcies filed, illness or injury is the cause of the filing.<sup>14</sup>

There is a problem with including personal injury recoveries in the bankruptcy estate: bankruptcy allows creditors to levy the flesh of innocent debtors. A tort victim loses an arm to a dog bite and in turn brings suit for the injuries. Between filing suit and settlement of the claim, the uninsured victim is forced to file chapter 7 bankruptcy because the victim is uninsured, has incurred countless medical bills, is unable to secure gainful employment as a result of the injuries, and is in need of a discharge from unsecured debt that was incurred at the bequest of all-too-willing creditors.<sup>15</sup> After filing bankruptcy, the debtor receives the right to a \$105,000 settlement of the claim.<sup>16</sup> The settlement is intended in part to figuratively replace the arm of

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<sup>9</sup> United States Census Bureau, *Income, Poverty, and Health Insurance Coverage in the United States: 2004*, at 60 (Aug. 2005).

<sup>10</sup> Statistics Department, National Safety Council, *Estimating the Costs of Unintentional Injury, 2005*, available at <http://www.nsc.org/Irs/statinfo/estcost.htm> [hereinafter National Safety Council]. Injuries cited include automobile accidents, home injuries, public injuries, and work injuries. *Id.*

<sup>11</sup> See generally 1 DAN B. DOBBS, *THE LAW OF TORTS* Ch. 1, §§ 1-6 (1993).

<sup>12</sup> See *id.* § 10.

<sup>13</sup> See generally ELIZABETH WARREN & JAY WESTBROOK, *THE LAW OF DEBTORS AND CREDITORS* (4th ed. 2001).

<sup>14</sup> See Melissa B. Jacoby, *Collecting Debts From the Ill and Injured: The Rhetorical Significance, But Practical Irrelevance, of Culpability and Ability to Pay*, 51 AM. U.L. REV. 229, 235 (2001).

<sup>15</sup> See, e.g., *In re Dorsey*, 120 B.R. 592, 596 (Bankr. M.D. Fla. 1990) (unsecured credit card debt of \$106,000 despite no identifiable and set income); see also Legislative Update, *Expanding Credit Card Debt: The Role of Creditors and the Impact on Consumers*, 17 AM. BANKR. INST. J., Feb. 1998, 6.

<sup>16</sup> See, e.g., *In re Hughes*, 318 B.R. 704 (Bankr. W.D. Mo. 2004) (annuity payments totaling \$105,000 for dog bite received as child, victim later filed bankruptcy).

the victim and in part to offset the costs of living and medical expenses because the debtor is now relegated to limited-income employment due to her injuries. However, because the cause of action accrued prepetition, the right to receive the settlement funds is no longer the property of the debtor.<sup>17</sup> Rather, the funds are the property of the bankruptcy estate, for the trustee in bankruptcy to collect and divide amongst unsecured creditors.<sup>18</sup> If the debtor lives in a state that permits use of federal bankruptcy exemptions, the debtor may keep \$18,450 of the settlement.<sup>19</sup> However, if the debtor lives in a state which does not permit the use of federal bankruptcy exemptions, the debtor may have to forego the entire settlement amount.<sup>20</sup> The debtor is thus left without compensation for the loss of his arm. Instead, unsecured creditors take the figurative arm of the debtor to satisfy the debts. This is an inappropriate debt collection practice.

Furthermore, in light of the staggering costs of even routine medical treatment<sup>21</sup> and the subjectivity of personal loss, a legislature cannot accurately estimate the medical expenses of a disabled member of society by ascribing a set exemption amount for a personal injury award. A legislature cannot place a meaningful value upon a tort recovery meant to compensate an individual for a subjective loss. As such, legislative attempts to make such an estimate poorly approximate the amount that an injured debtor will need to sustain the standard of living necessary to prevent future reliance upon social welfare programs for support, or worse, reliance upon other creditors. Considering the fundamental purposes of bankruptcy and tort law, a meager, inflexible, legislatively ascribed exemption for a personal injury recovery is a poor way to compensate an injured debtor and afford the fresh start necessary to prevent future costs to society, creditors, and insurance companies. Legislatures should take into account the aims of bankruptcy, tort law, and the interests of society in assuring adequate compensation to its injured.

This Comment will address the implications of including an award for personal injury in the bankruptcy estate and the ironies underlying the practice in light of the competing, yet parallel, goals of tort law and bankruptcy law. I will present the conflict between the policies underlying the formation of the

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<sup>17</sup> See 11 U.S.C.A. § 541(a)(1) (West 2005).

<sup>18</sup> See *id.*

<sup>19</sup> See *id.* § 522(d)(11)(D).

<sup>20</sup> See, e.g., ARIZ. REV. STAT. ANN. § 33-1126 (2005) (no exemption for personal injury recovery).

<sup>21</sup> See generally National Center for Injury Prevention and Control, *Cost of Injury in the United States: A Report to Congress* (1989), available at [http://www.cdc.gov/ncipc/pub-res/cost\\_of\\_injury/cost.htm](http://www.cdc.gov/ncipc/pub-res/cost_of_injury/cost.htm).

bankruptcy estate and those governing the right to recovery in tort for personal injury, examine the development of the laws governing the bankruptcy estate with regard to personal injury awards, and offer a suggestion for the reformation of the laws governing exemption of such awards from the bankruptcy estate.

Tort law compensates injured tort victims for their loss while bankruptcy law disregards an insolvent tort victim's rights to recovery in favor of compensating financially solvent creditors. Courts have struggled with the conflicting policies underlying tort law and bankruptcy law. Contrary to the purpose of tort law, courts eventually abided by the Bankruptcy Act of 1978 and began including personal injury recoveries in the bankruptcy estate. A debtor may exempt a portion of such an award from the estate, however, such exemptions are limited in amount. In order to protect the interests of an injured debtor in a fresh start after bankruptcy, prevent the social costs of injury from draining public resources, and preserve the credit facilities of credit-granting institutions for future debtors, legislatures need to increase exemption amounts to better reflect the actual loss of injured debtors and bankruptcy judges need to be able to exercise more discretion over the formation of the bankruptcy estate.

## I. FLESHING OUT THE POLICIES: THE COMPETING, YET PARALLEL, GOALS OF TORT COMPENSATION AND CREDITOR COMPENSATION

### A. Introduction

Tort law and bankruptcy law are competing, yet parallel, systems of compensation.<sup>22</sup> Tort law aims to compensate the victim of a tort for his losses, while bankruptcy law aims to compensate a creditor for its losses.<sup>23</sup> Tort law is primarily concerned with placing an injured victim in the position that he was in prior to being injured.<sup>24</sup> Bankruptcy law is concerned with assisting creditors in collecting outstanding debts and assuring that a debtor has a financial fresh start after bankruptcy.<sup>25</sup> Thus, both tort law and bankruptcy law are concerned with assuring that a debtor can financially support himself.<sup>26</sup>

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<sup>22</sup> See discussion *infra* Parts I.B–E.

<sup>23</sup> See discussion *infra* Parts I.B–E.

<sup>24</sup> See DOBBS, *supra* note 11, § 10.

<sup>25</sup> DAVID G. EPSTEIN ET AL., BANKRUPTCY Ch. 1, § 1-2 (1993).

<sup>26</sup> See discussion *infra* Parts I.B–E.

The conflict arises when a debtor is compensated in tort but a bankruptcy creditor lays claim to that compensation to satisfy outstanding debts of that debtor.<sup>27</sup> If a debtor receives the full amount of his tort award, creditors are cheated but the purposes of tort law are fulfilled.<sup>28</sup> However, if a bankruptcy trustee is allowed to distribute the award to unsecured creditors, the creditors are satisfied but the injured debtor remains uncompensated and without a fresh start.<sup>29</sup>

### B. Principles of Tort Law

A fundamental principle of tort law is to compensate the tort victim.<sup>30</sup> The victim of a tort should be compensated for his losses incurred due to the actions of a wrongdoer.<sup>31</sup> Accordingly, compensation is awarded to a tort victim to place him back in a position similar to that prior to the tort.<sup>32</sup> Money is awarded to make the victim of a tortious act whole by compensating for physical loss and pain and suffering,<sup>33</sup> replacing the value of damaged property,<sup>34</sup> or replacing a lost expectancy.<sup>35</sup> In short, as a general matter tort law is concerned with compensating the victim's loss.<sup>36</sup> As such, a monetary award in tort is a figurative, however ephemeral, substitute for what the victim lost.<sup>37</sup>

Specifically, in an action for personal injury, money damages are a substitute for the tangible losses of the victim.<sup>38</sup> Monetary awards for breach of contract fulfill the expectations of the aggrieved party or substitute for

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<sup>27</sup> See discussion *infra* Parts I.B–E.

<sup>28</sup> See discussion *infra* Parts I.B–E.

<sup>29</sup> See discussion *infra* Parts I.B–E.

<sup>30</sup> See DOBBS, *supra* note 11, § 10.

<sup>31</sup> *Id.*

<sup>32</sup> RESTATEMENT (SECOND) OF TORTS § 901, cmt. a (2005). The Restatement (Second) of Torts lists and explains four primary principles underlying tort law: “(a) to give compensation, indemnity or restitution for harms; (b) to determine rights; (c) to punish wrongdoers and deter wrongful conduct; and (d) to vindicate parties and deter retaliation or violent and unlawful self-help.” *Id.* § 109. Those four goals derive in varying degree from all forms of torts, from personal injury to breach of contract. *Id.* The primary concern of this Comment is the goal of tort law pertaining to compensation for personal injuries, namely the purpose of compensating victims of torts causing personal injuries.

<sup>33</sup> See generally DOBBS, *supra* note 11, § 6.

<sup>34</sup> *Id.* § 4.

<sup>35</sup> *Id.* § 3.

<sup>36</sup> See CHARLES T. MCCORMICK, DAMAGES Ch. 1, § 1 (1935).

<sup>37</sup> See DAN B. DOBBS, TORTS AND COMPENSATION Ch. 1, § 1 (1985).

<sup>38</sup> See generally DOBBS, *supra* note 11, § 1.

performance.<sup>39</sup> Property damaged by tortious trespass is replaced by a monetary award that approximates the lost value of the property.<sup>40</sup> Similarly, tort law compensates the physically injured victim for the loss of flesh. An award in tort does for the debtor what the debtor is unable to do for himself due to the loss of or injury to a body part: provide financial support for him and his dependents.<sup>41</sup> Compensation for personal injury takes into account pecuniary losses by awarding the debtor with money to replace lost earnings, pay medical expenses, and compensate for physical loss.<sup>42</sup> Just as the debtor's flesh is essential to his ability to work and support himself, the replacement of tangible losses is essential to the financial solvency of an injured tort victim.<sup>43</sup> The debtor may suffer lost earning capacity and yet be responsible for increased medical expenses. When tangible losses of the debtor are included in the bankruptcy estate the debtor is forced to look elsewhere for support.

An award for intangible losses, while more difficult to quantify than an award for tangible losses, is no less important to a tort victim. Nonpecuniary damages compensate the victim for intangible injuries such as mental pain and suffering.<sup>44</sup> An award for nonpecuniary losses serves in part to compensate the victim for the trouble of having to cope with a physical loss.<sup>45</sup> In extreme cases, an award for nonpecuniary losses may also serve a punitive role.<sup>46</sup> Principally, nonpecuniary damages replace the victim's intangible losses: dignity, a sense of self-worth, and a positive outlook on life.<sup>47</sup> Thus, to the extent that damages for intangible losses compensate for the loss of mental sanctity, the debtor may be forced to look elsewhere to cope.<sup>48</sup>

The theory underlying any award of compensation for personal injury is two-fold.<sup>49</sup> First, in equity and fairness to the tort victim, any injury incurred

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<sup>39</sup> *Id.* § 3.

<sup>40</sup> *Id.* § 4.

<sup>41</sup> DOBBS, *supra* note 37.

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> See DOBBS, *supra* note 11, § 1.

<sup>45</sup> See RESTATEMENT (SECOND) OF TORTS § 901(a), (c) (2005).

<sup>46</sup> *Id.* at (c), cmt. (c).

<sup>47</sup> See DOBBS, *supra* note 37, Ch. 1, § 1.

<sup>48</sup> See DOBBS, *supra* note 11, § 10 (suggesting that drug use maybe a consequence of not compensating the injured).

<sup>49</sup> See RESTATEMENT (SECOND) OF TORTS § 901; DOBBS, *supra* note 11, §§ 6-10; MCCORMICK, *supra* note 36, § 1.

at the hands of a wrongdoer should be compensated, whether it is a deterioration of body or mind.<sup>50</sup>

[W]hen the plaintiff has been harmed in body or mind, money damages are no equivalent but are given to compensate the plaintiff for the pain or distress or for the deterioration of the bodily structure . . . [and] [i]n other situations, as when there has been harm to earning capacity, the law can indemnify the plaintiff for a pecuniary loss although the indemnity is not the exact equivalent, but one that approximates the pecuniary harm the injured person has suffered or is likely to suffer in the future.<sup>51</sup>

Thus, an award of compensation to a tort victim is personal in the sense that it figuratively replaces something lost by the victim, e.g., an arm, a leg, a pound of flesh.<sup>52</sup> Second, as a matter of social economics, the tort victim should be directly compensated for his injuries and placed in a position that is as close to his pre-injury condition as possible so that society is not forced to bear the long-term costs of a now disabled member.<sup>53</sup> “Injury . . . has ripple effects especially when it promotes economic hardship[,]”<sup>54</sup> such as loss of earning capacity or a complete inability to carry out gainful employment, and will inevitably lead to ongoing costs to society if an injured tort victim is not properly compensated.<sup>55</sup> To that extent, tort compensation has a global social aspect as well. Thus, damages for personal injury are awarded to compensate the victim by figuratively replacing their flesh, and to prevent further loss to society by providing them with adequate means of support.

### *C. Principles of Bankruptcy Law*

While the law of torts is primarily concerned with compensating the personally injured party for the benefit of the individual and society, the law of bankruptcy is aimed at assuring the equitable distribution of a wayward

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<sup>50</sup> See RESTATEMENT (SECOND) OF TORTS § 901 cmt. c; see also DOBBS, *supra* note 11, § 9 (tort law as a means by which to hold accountable a wrongdoer for harmful conduct). Although not addressed in detail here, compensating a tort victim also complements the goal of deterring the wrongdoer from similar future conduct. See RESTATEMENT (SECOND) OF TORTS § 901 cmt. c.

<sup>51</sup> RESTATEMENT (SECOND) OF TORTS § 901 cmt. a.

<sup>52</sup> See *id.*

<sup>53</sup> See DOBBS, *supra* note 11, § 10.

<sup>54</sup> *Id.*

<sup>55</sup> See *id.* (“Compensation is also socially desirable, for otherwise the uncompensated injured persons will represent further costs and problems for society.”). Dobbs suggests that some of these problems for society include a diminished workforce, drug use, and economic strain resultant from expenses incurred supporting and treating the injured. See *id.*

debtor's assets for the benefit of interested creditors.<sup>56</sup> It is primarily concerned with the economical conversion of assets from the ownership of a debtor to the ownership of creditors.<sup>57</sup> To facilitate the conversion of assets, the law of bankruptcy provides tools that facilitate the organized collection and distribution of the debtor's interests in property.<sup>58</sup> In its most basic form, the Code establishes the estate,<sup>59</sup> sets forth guidelines for allowing claims,<sup>60</sup> and creates rules for distribution of the assets of the debtor.<sup>61</sup> Devices are put into place to protect the assets of the debtor from being transferred beyond the grasp of creditors and from tipping the scale in favor of one creditor over another.<sup>62</sup> The trustee is charged with managing the estate and always keeping in mind the interests of the creditors when doing so.<sup>63</sup> The primary thrust of these provisions is to provide tools for the trustee with which to amass the assets of the debtor for the benefit of the creditors.<sup>64</sup>

Counterbalancing the interests of the creditors in bankruptcy are the interests of society and the interests of the honest, yet troubled, debtor.<sup>65</sup> Secondary to the functions of debt collection and asset distribution, the law of bankruptcy is concerned with affording the debtor an opportunity for a fresh financial start.<sup>66</sup> This policy protects the debtor from becoming desolate, and

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<sup>56</sup> EPSTEIN ET AL., *supra* note 25, § 1-2.

<sup>57</sup> THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* 5 (Harvard Univ. Press 1986). Jackson notes that while bankruptcy law also is concerned with affording the debtor a fresh start, such a policy is distinct from the primary goal of debt collection. *See id.* at 226-27. Discharge affording the debtor a fresh start is driven by a policy of promoting social welfare by limiting the pull of a desolate debtor on the resources of society. *See id.* at 231-32. In a debt collection regime such as bankruptcy that affords a discharge to a debtor, the end of the debt collection process is simply a logical and natural place for the fresh start. *Id.* Thus, the two policies, however distinct, underlie the law of bankruptcy. *See id.* at 227. However, bankruptcy as a debt collection device most likely could survive even without the policy of affording the debtor a fresh start. *See* WARREN & WESTBROOK, *supra* note 13, at 161 (bankruptcy began as a debt collection device and discharge developed separately under the law of insolvency). Thus, since its earliest days and arguably continuing to the present, bankruptcy was and is a device primarily used for debt collection and asset distribution.

<sup>58</sup> *See* EPSTEIN ET AL., *supra* note 25, § 1-2.

<sup>59</sup> *See* 11 U.S.C. § 541 (2000).

<sup>60</sup> *See id.* § 502.

<sup>61</sup> *See id.* § 507.

<sup>62</sup> *See, e.g., id.* § 547 (avoidance of preferential transfers).

<sup>63</sup> *See, e.g., id.* § 544, (powers of avoidance); *see also* EPSTEIN ET AL., *supra* note 25, § 6-2 (the reason that the trustee is given the avoiding powers is to "enlarge the estate for the benefit of the creditors").

<sup>64</sup> *See* EPSTEIN ET AL., *supra* note 25, § 1-2 (bankruptcy is primarily a debt collection system).

<sup>65</sup> *See id.*

<sup>66</sup> *See* JACKSON, *supra* note 57, at 226 n.4 (Harvard Univ. Press 1986). Jackson notes that the policy of affording a debtor a fresh start is a relatively new goal of bankruptcy law due to bankruptcy's origin as solely a debt collection device and the fact that discharge was originally only another tool for a creditor to use in its efforts to uncover and secure a debtor's assets instead of a way to grant a fresh start to the debtor. *See id.*

in turn protects society and creditors alike.<sup>67</sup> A debtor is provided enough property and income to ensure that after discharge he is not forced to seek social welfare assistance or new debt to survive.<sup>68</sup> To ensure that the debtor can survive after bankruptcy without undue reliance upon social welfare programs or new credit, the interests of the debtor in certain property are protected throughout the process: certain property held prepetition that is essential to survival is exempt from the estate for the debtor's use during and after the bankruptcy.<sup>69</sup> For example, postpetition earnings of the debtor are not included in the estate so they can be used to fund a fresh start;<sup>70</sup> discharge is granted so that the debtor may use his prepetition property and postpetition earnings without the drain of old debt.<sup>71</sup> Protecting the debtor's interests as such minimizes the risk that the debtor will burden society or creditors by incurring additional financial assistance or debt to survive.<sup>72</sup> In short, the debtor is given a fresh start so that he will be able to stay solvent.<sup>73</sup>

#### *D. Tort Law and Bankruptcy Law as Compensation Schemes*

Despite their differences, both tort law and bankruptcy law are in essence schemes of compensation. Tort law seeks to compensate individuals who suffered losses due to the intentional, negligent, or reckless wrongs of another, while bankruptcy aims to compensate creditors who have suffered losses due to the financial negligence or recklessness of a debtor, macroeconomic causes, or other factors that lead the debtor to dire financial straits. Therein lies the fundamental problem addressed in this Comment: the policies underlying bankruptcy and tort compensation schemes are at odds on the issue of who needs the compensation more, tort victims or creditors. In a bankruptcy proceeding where the debtor has the rights to a personal injury action which arose prepetition, tort law dictates that the recovery realized from that action be

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Bankruptcy began as a debt collection device and arguably is still concerned primarily with debt collection. See EPSTEIN ET AL., *supra* note 25, § 1-2; see also *supra* note 57.

<sup>67</sup> See H.R. REP. NO. 95-595, at 126, as reprinted in 1978 U.S.C.C.A.N. 5963, 6087 (1977) (“The historical purpose of . . . exemption laws has been to protect a debtor from his creditors, to provide him with the basic necessities of life so that even if his creditors levy on all of his nonexempt property, the debtor will not be left destitute and a public charge. [This] purpose has not changed . . .”).

<sup>68</sup> See *id.*

<sup>69</sup> See 11 U.S.C.A. § 522(d) (West 2005).

<sup>70</sup> See *id.* § 541(a)(1).

<sup>71</sup> See *id.* § 727.

<sup>72</sup> H.R. REP. NO. 95-595, at 126, as reprinted in 1978 U.S.C.C.A.N. 5963, 6087 (1977).

<sup>73</sup> See *id.*

used to compensate the debtor for the ultimate benefit of society.<sup>74</sup> Bankruptcy law seeks to use the recovery to compensate the creditor.<sup>75</sup> While bankruptcy law provides some exemptions for personal injury recoveries, those exemptions usually fall short of satisfying the debtor's right to be compensated under tort law.<sup>76</sup> Thus, it is questionable whether the policy of granting a debtor a fresh start after bankruptcy is fully realized when the debtor is the victim of a tort that caused personal injury. Aligning bankruptcy policy with the tort law policy actually will lead to the utility of the fresh start because an injured debtor who receives the recovery that is needed is less likely to be a future credit risk or drain on public funds.

### *E. The Misalignment of Personal Injury Awards and Bankruptcy Exemptions*

Generally, an injured bankruptcy debtor may only exempt a recovery for tangible losses.<sup>77</sup> The debtor may exempt \$18,450 on account of "personal bodily injury."<sup>78</sup> In addition, the debtor may exempt the amount necessary for support of a recovery meant to compensate for lost future earnings.<sup>79</sup> However, many statutes do not provide a debtor with an express exemption for funds set aside to cover medical expenses related to personal injury.<sup>80</sup>

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<sup>74</sup> See discussion *supra* Parts I.B and C.

<sup>75</sup> See discussion *supra* Parts I.B and C.

<sup>76</sup> This also is evidenced by a system of exemptions for personal injury awards and lost earnings payments that at best contradicts itself and at worst favors stable creditors over disabled debtors. See generally Louis J. Papera, *Confusion Over § 522(d)(11)(D): What Congress Really Meant by Exempting Payments for "Personal Bodily Injury" and Why They Got It Wrong*, 16 BANKR. DEV. J. 503 (2000) (espousing the theory that Congress used bankruptcy law to override a debtor's right to tort compensation under state law by literally writing out of the exemption statute all the elements of a personal injury recovery).

<sup>77</sup> 11 U.S.C.A. § 522(d)(11)(D) (West 2005).

<sup>78</sup> *Id.*

<sup>79</sup> See *id.* § 522(d)(11)(E). It would seem logical to conclude that the amount prescribed by § 522(d)(11)(D) is intended to preserve the debtor's entitlement to recover his actual physical loss. However, the statute clearly disavows this conclusion. It is unclear what exactly the \$18,450 is intended to compensate the debtor for if it is not pain and suffering, actual physical loss, or lost future income. There is confusion as to what rationale underlies the personal injury exemption in the federal bankruptcy scheme. See Papera, *supra* note 76, at 536. One author concluded that Congress most likely intended to exempt only recovery for actual physical injury; however, it missed the mark with language that nullifies itself. The author also concluded that the practice of limiting exemptions for personal injury is contrary to the principles of tort law. *Id.*

<sup>80</sup> See, e.g., § 522(d) (no exemption for medical expenses); see also *In re Bippert*, 311 B.R. 456, 470 n.24 (Bankr. W.D. Tex. 2004) ("according to the legislative history, it would not be necessary to allow exemption for reimbursement for medical expenses because Congress presumed that medical providers already had a constructive trust on any personal injury award for their expenses, and the constructive trust would not be property of the estate anyway"); *Claude v. Claude (In re Claude)*, 206 B.R. 374, 376 (Bankr. W.D. Pa. 1997) ("The § 522(d)(11)(D) exemption does not cover awards for pain and suffering or reimbursement for pecuniary losses such as lost wages or medical expenses.") (citing 4 COLLIER ON BANKRUPTCY, ¶522.09[11], at 522-67 (15th ed., rev. 2003)). However, the logic of Congress is strained when considered in light of

Furthermore, a debtor typically cannot exempt a recovery for intangible losses such as pain and suffering or punitive damages because of their subjective and hard-to-quantify nature.<sup>81</sup> Because a tort victim may suffer losses that include tangible physical loss, intangible mental loss, medical expenses, loss of earning capacity, and actual loss of future income,<sup>82</sup> an injured debtor will likely suffer economic and noneconomic loss in excess of his exemption amount.<sup>83</sup> Furthermore, in light of the difficulty of assessing the cost of physical loss to an individual,<sup>84</sup> set exemption amounts for physical loss often cannot accurately estimate an individual debtor's needs. The concern over the potential for long-term indebtedness, inability to pay medical expenses, and the risk of unhealthy coping methods as a result of a limited exemption of an injured debtor's recovery for tangible and intangible losses becomes more pronounced and more ironic when considered in the context of the underlying purposes of bankruptcy to compensate creditors and to provide a debtor with a fresh start and an opportunity to stay solvent.<sup>85</sup> As such, the bankruptcy exemptions need to be reformed to advance the policies underlying tort law as opposed to being concerned with compensation of large creditors.

## II. THE BANKRUPTCY ESTATE: HOW BANKRUPTCY EXCISES FLESH

### A. Introduction

The bankruptcy estate is formed upon the filing of a bankruptcy petition and includes all legal and equitable interests of the debtor as of the commencement of the case.<sup>86</sup> Historically, a personal injury cause of action, and hence recovery, were excluded from the bankruptcy estate on the grounds

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continuing medical expenses *after* the personal injury award is exhausted. A debtor's award would first be diminished by a hospital's claims, the remainder going to the bankruptcy estate less the debtor's exemption, leaving only the set exemption amount to cover any ongoing medical expenses due to the debtor's injury. If the debtor is permanently disabled, ongoing treatment may be costly and the cost of physical therapy and medications and office visits may leave a debtor insolvent again.

<sup>81</sup> § 522(d)(11)(D).

<sup>82</sup> See discussion *supra* Parts I.A–B.

<sup>83</sup> See generally National Safety Council, *supra* note 10; National Center for Injury Prevention and Control, *supra* note 21.

<sup>84</sup> See generally Randall R. Bovbjerg, et al., *Public Policy: Valuing Life And Limb In Tort: Scheduling "Pain And Suffering,"* 83 NW. U.L. REV. 908 (Summer 1989).

<sup>85</sup> EPSTEIN ET AL., *supra* note 25, §1-2.

<sup>86</sup> § 541(a).

that personal injury was personal to the debtor and could not be assigned.<sup>87</sup> With the Bankruptcy Reform Act of 1978, the bankruptcy estate was to include causes of action for personal injury.<sup>88</sup> Due to concern over adequately compensating an injured debtor, courts were reluctant to follow that provision.<sup>89</sup> Eventually, every circuit adopted the reading of the Bankruptcy Reform Act of 1978 that included causes of action in the estate.<sup>90</sup>

*B. The Bankruptcy Estate: 11 U.S.C. § 541*

The estate is the pool of assets from which the creditors are compensated.<sup>91</sup> The estate includes, with certain exceptions,<sup>92</sup> “any legal or equitable interests of the debtor in property as of the commencement of the case.”<sup>93</sup> In defining the estate, the Code furthers the two fundamental purposes of bankruptcy law: “(1) [the Code and § 541] provid[e] protection for the creditors of the insolvent debtor and (2) permit the debtor to carry on and rebuild his life, that is, to make a ‘fresh start.’”<sup>94</sup> The purpose of compensating creditors is “effectuated through statutory provisions that marshal and consolidate the debtor’s assets into a broadly defined estate from which, in an equitable and orderly process, the debtor’s unsatisfied obligations to creditors are paid to the extent possible.”<sup>95</sup> The debtor is given a fresh start because of the

bright line the Bankruptcy Code draws between pre- and post-bankruptcy filing events. Thus, § 541(a)(1) provides that the estate includes the debtor’s legal and equitable interests “as of the commencement of the case,” and leaves the bankrupt debtor free after that date to accumulate new wealth so that he might make a fresh start following bankruptcy.<sup>96</sup>

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<sup>87</sup> Bankruptcy Reform Act, § 110(a) (1976) (current version available at 11 U.S.C.A. § 541 (West 2005)).

<sup>88</sup> 11 U.S.C.A. § 541(a) (West 2005).

<sup>89</sup> See generally *Sierra Switchboard Co. v. Westinghouse Electric Corporation*, 789 F.2d 705, 707 (9th Cir. 1986).

<sup>90</sup> *Id.*

<sup>91</sup> See generally § 541.

<sup>92</sup> Certain interests are at the outset excluded from the newly formed estate. § 541(b). Those interests are listed in § 541(b) and § 541(c)(2).

<sup>93</sup> § 541(a)(1).

<sup>94</sup> *Andrews v. Riggs Nat’l Bank (In re Andrews)*, 80 F.3d 906, 909 (Va. 1996) (internal citation omitted).

<sup>95</sup> *Id.* at 909–10.

<sup>96</sup> *Id.* at 910 (internal citation omitted).

The definition of the estate is given a broad reading to further the Act's goals.<sup>97</sup> Accordingly, the estate includes not only possessory interests in property but also property to which the debtor holds legal title without possession.<sup>98</sup> This includes tangible and intangible property.<sup>99</sup> Furthermore, the estate includes the right of the debtor to causes of action accruing prepetition.<sup>100</sup> Thus, a claim for compensation for personal injury can be assigned to the bankruptcy trustee, and the trustee is obligated to pursue the action for the benefit of the creditors.<sup>101</sup>

The United States Supreme Court first addressed § 541 in *United States v. Whiting Pools*.<sup>102</sup> There the debtor filed a petition for chapter 11 bankruptcy as a result of the seizure by the government of the debtor's tangible property to satisfy a tax lien.<sup>103</sup> While the Supreme Court granted certiorari to address a split amongst the circuits as to whether the automatic stay barred the attempts of the Internal Revenue Service to satisfy the tax lien,<sup>104</sup> it addressed § 541 as a matter of first impression.<sup>105</sup> The language of the statute indicates that the scope of the estate is broad: "the 'estate is comprised of all the following property, wherever located: . . . all legal or equitable interests of the debtor in property as of the commencement of the case'. . . . [Section 541(a)(1)] is broad in scope and 'includes all kinds of property, including tangible or

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<sup>97</sup> See generally S. REP. NO. 95-989, as reprinted in 1978 U.S.C.A.N. 6307 (1978).

<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

<sup>100</sup> 11 U.S.C.A. § 541(a)(1) (West 2005); *In re Baker*, 709 F.2d 1063, 1064 (6th Cir. 1983) ("the bankrupt estate includes choses in action and claims held by the debtor against third parties only if the claims could have been assigned prior to bankruptcy").

<sup>101</sup> § 323; see also *In re E.F. Hutton Southwest Prop. II, Ltd.* 103 B.R. 808, 812 (Bankr. N.D. Tex. 1989). *But see* S. REP. NO. 95-989 ("Though this paragraph will include choses in action and claims by the debtor against others, it is not intended to expand the debtor's rights against others more than they exist at the commencement of the case. For example, if the debtor has a claim that is barred at the time of the commencement of the case by the statute of limitations, then the trustee would not be able to pursue that claim, because he too would be barred. He could take no greater rights than the debtor himself had.").

<sup>102</sup> 462 U.S. 198 (1983).

<sup>103</sup> *Id.* at 199. The debtor sought turnover of the property pursuant to § 542, claiming that the seizure violated the automatic stay of § 362. *Id.* The Internal Revenue Service argued that the automatic stay was not applicable to their attempts to satisfy a tax lien. *Id.* at 201. The bankruptcy court held that a turnover was proper, the district court reversed, and the court of appeals reversed the district court and affirmed the turnover granted by the bankruptcy court. *Id.* at 200-01.

<sup>104</sup> *Id.* at 202.

<sup>105</sup> *Id.* The Court held that the bankruptcy estate includes property of the debtor that has already been seized by a secured creditor prior to filing bankruptcy. *Id.* at 208. Congress made no exception for the Internal Revenue Service. *Id.* at 209. Instead of keeping the seized property securing the tax lien, the Internal Revenue Service was entitled to adequate protection of its interests secured by the lien under § 363. *Id.* at 211-12. Thus, the property seized was subject to turnover. *Id.* at 212.

intangible property, causes of action . . . and all other forms of property currently specified in section 70a of the Bankruptcy Act.”<sup>106</sup> As such, the Supreme Court set forth the standards for defining the bankruptcy estate under the Bankruptcy Act of 1978.<sup>107</sup>

### *C. The Confusion over Personal Injury Causes of Action and Recoveries*

Despite the clear legislative intent to include a debtor’s rights to causes of action for personal injury in the bankruptcy estate, the circuits were confused on the issue until 1986, nearly eight years after the adoption of § 541.<sup>108</sup> The confusion centered around the language of section 70(a)(5) of the Bankruptcy Act of 1898,<sup>109</sup> the predecessor to § 541 of the Bankruptcy Reform Act of 1978. While § 541 includes all property of the debtor in the estate without regard to whether it can be assigned under state law, section 70(a)(5) specifically excluded from the estate property interests that were not able to be assigned under state law.<sup>110</sup> Under section 70(a)(5) personal injury causes of action were excluded from the estate unless state law provided that they were subject to attachment.<sup>111</sup> Initially, courts abided by the broad reading of § 541 and recognized the elimination of the requirement that the cause of action be

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<sup>106</sup> *Id.* at 205 n.9 (quoting H. R. REP. NO. 95-595, as reprinted in 1978 U.S.C.C.A.N. 5963 (1977)).

<sup>107</sup> Courts consistently rely on similar formulations of the estate. *See, e.g.*, *Sierra Switchboard Co. v. Westinghouse Electric Corporation*, 789 F.2d 705, 707 (9th Cir. 1986) (relying on *United States v. Whiting Pools*, 462 U.S. 198 (1983), and stating that the definition of the estate is broad and includes causes of action). Section 541(a) remains unchanged with the Bankruptcy Reform Act of 2005. 11 U.S.C.A. § 541(a) (West 2005).

<sup>108</sup> *See generally Sierra Switchboard*, 789 F.2d at 707 (explaining the confusion amongst the circuits).

<sup>109</sup> Bankruptcy Reform Act, § 70(a)(5)(1976) (current version at 11 U.S.C.A. § 541 (West 2005)).

<sup>110</sup> *Id.* The relevant language of section 70(a)(5) stated:

The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt . . . to all of the following kinds of property wherever located . . . (5) property, including rights of action, which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered: Provided, that rights of action *ex delicto* for libel, slander, injuries to the person of the bankrupt or of a relative, whether or not resulting in death, seduction, and criminal conversation shall not vest in the trustee *unless by the law of the State such rights of action are subject to attachment, execution, garnishment, sequestration, or other judicial process . . .*

*Id.*

<sup>111</sup> *Id.*

subject to assignment in order to be considered property of the estate.<sup>112</sup> However, the Fourth Circuit, Sixth Circuit, and at least one district court within the Seventh Circuit disregarded § 541 and instead quite inexplicably applied the test of section 70(a)(5) of the Bankruptcy Act of 1898. The Ninth Circuit was responsible for bringing all eleven circuits into accord in 1986.<sup>113</sup>

### 1. *The Sixth Circuit*

In *Baker v. Auger*,<sup>114</sup> the debtor and his insurance company were defendants in a personal injury suit.<sup>115</sup> The plaintiff in that suit filed an involuntary chapter 7 petition on the defendant and sought the rights to sue the defendant's insurance company for indemnification.<sup>116</sup> The bankruptcy court had previously dismissed the involuntary petition and the district court affirmed because the only asset that the plaintiff sought through the petition was the right to sue for indemnification.<sup>117</sup> The court of appeals affirmed and in doing so cited the language of § 541(a) but mysteriously relied on the logic and mandate of former section 70(a)(5). The court of appeals looked to whether the cause of action was assignable under state law:<sup>118</sup> "Under § 541(a) of the Bankruptcy Code, the bankrupt estate includes choices in action and claims held by the debtor against third parties only if the claims could have been assigned prior to bankruptcy."<sup>119</sup> The court concluded that the "[cause of] action is not assignable under Michigan law and that, therefore, the Bankruptcy Court correctly dismissed the involuntary petition."<sup>120</sup>

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<sup>112</sup> See, e.g., *In re Bush Gardens*, 10 B.R. 506 (Bankr. D.N.J. 1979) (describing broad reach of § 541, but excluding a liquor license from estate due to superior interest of United States in the property to satisfy tax lien):

The underlying theory of Section 541(a)(1) is to bring into the estate *all* interests of the debtor in property as of the date the case is commenced . . . . It is clear that the concept of what is property of the estate under Section 541 radically differs from that under Section 70(a) of the Act. The requirement of Section 70(a)(5) that the debtor be able to transfer the property or his creditors reach it by judicial process has been eliminated by Section 541(a)(1).

*Id.* at 508–09 (quoting and citing 4 COLLIER ON BANKRUPTCY § 541.02 (Alan N. Resnick and Henry J. Sommer, eds., 15th ed. 1979)).

<sup>113</sup> See *Sierra Switchboard Co. v. Westinghouse Elec. Corp.*, 789 F.2d 705, 707 (9th Cir. 1986).

<sup>114</sup> 709 F.2d 1063 (6th Cir. 1983).

<sup>115</sup> *Id.* at 1064.

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

<sup>118</sup> *Id.* at 1064–65.

<sup>119</sup> *Id.* at 1064.

<sup>120</sup> *Id.*

The confusion of the old Code with the new Code was not later explained by the Sixth Circuit, however, the Circuit's reliance upon section 70(a)(5) was expressly disavowed in *Cottrell v. Schilling*.<sup>121</sup> That court summarily dealt with *Baker* as follows:

[I]t appears that the *Baker* decision applied pre-Bankruptcy Reform Act rationale in concluding that nonassignable causes of actions were excludable from the bankruptcy estate. It is apparent from a comparison of Section 541(a)(1) of the Bankruptcy Reform Act of 1978 with its analogous Section 70(a)(5) of the former Bankruptcy Act, 11 U.S.C. § 110(a)(5), which had specifically excluded personal injury actions from being classified as property of a bankruptcy estate if such actions were nonassignable under state law, that the legislative intent of Section 541 was to extend the definition of property to include all assignable and nonassignable causes of action including an action for personal injuries as assets of the bankrupt estate.<sup>122</sup>

The Sixth Circuit now relies upon *Cottrell* for its reading of § 541(a) that a prepetition cause of action is property of the estate regardless of whether it is assignable.<sup>123</sup>

## 2. *The Seventh Circuit*

At least one court within the Seventh Circuit also has relied upon section 70(a)(5) instead of § 541. In *In re Brandstaetter*,<sup>124</sup> the bankruptcy court held that a cause of action for personal injury accruing prepetition was exempt from the chapter 7 estate.<sup>125</sup> That court relied on the decision of the Seventh Circuit in *Hayes v. Buda (In re Buda)*.<sup>126</sup> There the court held that

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<sup>121</sup> 876 F.2d 540 (1989). That case involved a voluntary chapter 7 petition filed by a debtor that had filed a prepetition claim for personal injury. *Id.* at 540. The trustee prosecuted the claim on behalf of the estate while the debtor argued that the cause of action was not property of the estate because under state law the claim was not assignable. *Id.* at 541. The court of appeals upheld the rulings of the bankruptcy court and the district court that the cause of action was property of the estate. *Id.* at 543. The court of appeals relied on the legislative history of § 541 in concluding that, in the name of ease of application, a cause of action is property of the estate without regard to whether it is assignable at state law. *Id.* at 542.

<sup>122</sup> *Id.*

<sup>123</sup> See, e.g., *Demczyk v. Mutual Life Ins. Co. (In re Graham Square)*, 126 F.3d 823 (6th Cir. 1997) (cause of action based on contract is property of the estate).

<sup>124</sup> 36 B.R. 369 (Bankr. E.D. Wis. 1984), *aff'd on other grounds*, 767 F.2d 324 (7th Cir. 1985), *disapproved*, *In re Geise*, 992 F.2d 651 (7th Cir. 1993).

<sup>125</sup> *Id.*

<sup>126</sup> *Id.* at 370. The debtors relied on *Hayes v. Buda (In re Buda)*, 323 F.2d 748 (7th Cir. 1963), and *Peebles v. Sargent*, 77 N.W. 2d 612 (Wis. 1977), both decided under section 70(a)(5), to argue that the rights to a personal injury action were not property of the estate. *Brandstaetter*, 36 B.R. at 369; see also, *Peebles v.*

under section 70(a)(5) the rights to the cause of action were exempt from attachment because under Wisconsin state law there was no provision allowing a creditor to attach or subject to other judicial process a debtor's rights in a cause of action.<sup>127</sup> The bankruptcy court in *Brandstaetter*, relying on *Buda*, reasoned that even though Wisconsin did not expressly exempt causes of action for personal injury the cause of action was not available to creditors and implicitly exempt from the estate because under the law of Wisconsin such actions were not subject to attachment.<sup>128</sup> As such, the bankruptcy court recognized a common-law exemption from the bankruptcy estate<sup>129</sup> and subsequently affirmed the decision of the bankruptcy court.<sup>130</sup> The district court affirmed on the same grounds stated by the bankruptcy court.<sup>131</sup> The Court of Appeals for the Seventh Circuit affirmed the decision of the district court.<sup>132</sup>

On the face of the opinion it appears that the court in *Brandstaetter* merely allowed a debtor a common-law bankruptcy exemption for the rights in a personal injury cause of action under the Bankruptcy Reform Act of 1978. However, looking back to *Buda* it is clear that in *Brandstaetter* the Seventh Circuit in fact perpetuated its reliance upon section 70(a)(5) to determine whether property was for the estate. The court in *Buda* excluded a cause of action from the estate based on section 70(a)(5):

Under § 70 of the Bankruptcy Act all property, including rights of action, "which prior to the filing of the petition he [bankrupt] could by any means have transferred . . ." vests in the trustee. A proviso, however, excludes personal injury rights of action "unless by the law of the State such rights . . . are subject to attachment, execution, garnishment, sequestration or other judicial process."<sup>133</sup>

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Sargent, 253 N.W. 2d 459 (Wis. 1977) ("[b]ecause both the medical expenses claim and the loss of consortium [claim] are personal injury rights of action they do not vest in the trustee unless by the law of Wisconsin such rights [are subject to attachment . . . or other judicial process]").

<sup>127</sup> *Buda*, 323 F.2d at 750–51.

<sup>128</sup> *Brandstaetter*, 36 B.R. at 370.

<sup>129</sup> *Id.*

<sup>130</sup> *In re Brandstaetter*, 767 F.2d 324, 326 (7th Cir. 1985). The opinion of the district court is not published. *Id.* However, the decision was explained by the court of appeals. *Id.*

<sup>131</sup> *Id.*

<sup>132</sup> *Id.* The court did so on the grounds that the trustee had failed to file a timely objection to the debtor's exemption of the property from the estate. *Id.*

<sup>133</sup> *Hayes v. Buda (In re Buda)*, 323 F.2d 748, 749 (7th Cir. 1963) (quoting sections 70(a)(5) and 110(a) (current version available at 11 U.S.C.A. § 541 (West 2005))).

Because there was no provision under Wisconsin State law that permitted a creditor to reach the rights in a cause of action, the court in *Buda* excluded the property from the estate under section 70(a)(5).<sup>134</sup> Thus, by relying on *Buda* in affirming *Brandstaetter*, the district court implicitly relied upon section 70(a)(5).<sup>135</sup> While the court of appeals did not address the merits of implicitly relying upon section 70(a)(5), the decision of the district court was affirmed and thus remained authoritative.<sup>136</sup> It was not disapproved until 1990.<sup>137</sup>

In *In re Leck*, the bankruptcy court expressly contradicted the holding of *Brandstaetter* when it held that under the Bankruptcy Reform Act of 1978, a debtor could not exempt a cause of action under state law absent an express statutory exemption.<sup>138</sup> In *Leck* the debtor claimed as exempt a prepetition cause of action for personal injury.<sup>139</sup> The debtor relied on the common-law exemption recognized in *Brandstaetter*.<sup>140</sup> The *Leck* court implicitly disavowed the reliance upon *Buda* by the *Brandstaetter* court when it made clear that *Buda* was decided under the former Code whereas *Brandstaetter* was a case arising under the Bankruptcy Reform Act of 1978:<sup>141</sup> “[*Buda*] . . . predated the enactment of the Bankruptcy Code . . . [and] is not dispositive of whether such an action may be exempted from the estate under the current

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<sup>134</sup> *Id.* at 750.

<sup>135</sup> This is troubling because a post-1978 debtor could have conceivably relied upon the decision as authority for the use of section 70(a)(5) instead of § 541 to exclude property from the estate if there were no provision in state law which provided for attachment of given property, despite legislative intentions that the given property was better left to the creditors under § 541. *See, e.g., In re Leck*, 113 B.R. 500 (Bankr. W.D. Wis. 1990) (debtor relied upon *In re Brandstaetter*, 36 B.R. 369 (Bankr. E.D. Wis. 1985), to claim personal injury cause of action exempt; however, the court called into question *Brandstaetter*).

<sup>136</sup> *See id.*

<sup>137</sup> *Id.* Until then, courts relied on the decision of the bankruptcy court in *Brandstaetter* for the contention that a cause of action was not included in the estate even though that decision was affirmed on other grounds and its logic was questionable given its reliance upon *Buda* and the refusal by the court of appeals to address the merits of the decision. *See, e.g., P.V.N. Acharya v. Carroll*, 448 N.W. 2d 275, 279 (Ct. App. Wis. 1989) (relying on *Brandstaetter*, 36 B.R. 369, to allow an exemption from the bankruptcy estate).

<sup>138</sup> *Leck*, 113 B.R. at 504.

<sup>139</sup> *Id.* at 500.

<sup>140</sup> *Id.*

<sup>141</sup> *Id.* at 500–01. In similar fashion the court also called into question any reliance upon *Peeples v. Sargent*, 253 N.W. 2d 459 (Wis. 1977), in any case arising under the Bankruptcy Act of 1978. *Leck*, 113 B.R. at 501 n.1 (“that a personal injury cause of action may not have been property of the estate under the former Bankruptcy Act is not dispositive of whether such an action may be exempted from the estate under the current Bankruptcy Code”). In *Peeples*, the Wisconsin Supreme Court affirmed, on other grounds, a lower court decision excluding from the estate claims for medical expenses and loss of consortium arising from a personal injury because the rights were not subject to attachment or other judicial process under state law. *Peeples*, 253 N.W. 2d at 472.

Bankruptcy Code.”<sup>142</sup> Under the Bankruptcy Act of 1898 no statutory exemption was required to keep the rights to a cause of action out of the estate because such rights were only included in the estate if there were a provision in state law subjecting them to attachment or other judicial process to satisfy a debt.<sup>143</sup> To the contrary, under the broad reading of § 541 of the Bankruptcy Act of 1978, the rights to a prepetition cause of action are included in the estate and then exempt: “except for a constitutional provision or an express statute, all property of a debtor is liable for the debtor’s debts.”<sup>144</sup> The *Leck* court held that:

The relevant inquiry is thus no longer whether a personal injury action may be reached by a creditor’s collection efforts, but rather whether, in the case of a debtor electing his exemptions pursuant to 11 U.S.C. §522(b)(2), State or “other Federal law” exists pursuant to which such actions may be claimed exempt from property of the estate.<sup>145</sup>

Thus, whether a cause of action was subject to attachment or judicial process for satisfaction of a debt was no longer relevant; instead, an express statutory provision was necessary to exempt the property from the estate.<sup>146</sup>

In *In re Geise*,<sup>147</sup> the Seventh Circuit approved of the use of the *Leck* inquiry to determine whether a cause of action for personal injury was exempt from the estate.<sup>148</sup> The *Geise* court disapproved of *Brandstaetter* when it upheld the trustee’s objection to an exemption claimed under *Brandstaetter*.<sup>149</sup> Thus, despite the earlier reliance upon section 70(a)(5) in *Brandstaetter*, the Seventh Circuit eventually adopted the soon-to-be-prevailing standard for analyzing whether a cause of action was property of the estate under § 541.

### 3. *The Fourth Circuit*

Starting with what was perhaps the most salient example of defiance of § 541, the Fourth Circuit did not come into accord with that section until 1984.

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<sup>142</sup> *Leck*, 113 B.R. at 501 n.1.

<sup>143</sup> *Id.* at 504. The court relied on *Tignor v. Parkinson*, 729 F.2d 977 (4th Cir. 1977). *Id.* That case is discussed *infra* Part II.C.

<sup>144</sup> *Id.* at 503–04. The court relied on *Sierra Switchboard Co. v. Westinghouse Elec. Corp.*, 789 F.2d 705 (9th Cir. 1986), to explain the broad nature of the estate. *Id.*

<sup>145</sup> *Id.* at 504.

<sup>146</sup> *Id.*

<sup>147</sup> 992 F.2d 651 (7th Cir. 1993).

<sup>148</sup> *Id.* at 654–55.

<sup>149</sup> *Id.* at 654–55, 658.

In *In re Musgrove*,<sup>150</sup> the Bankruptcy Court for the Western District of Virginia applied the logic of section 70(a)(5) to a case falling squarely under § 541:<sup>151</sup>

The language of [Virginia's exemption statute] and of the cases [addressing § 70(a)(5)] make it clear that an unliquidated and contingent claim such as the one at bar . . . is *neither assignable nor subject to the reach of creditor process under Virginia law and is therefore exempt property pursuant to 11 U.S.C. § 522(b)(2)(A)*.<sup>152</sup>

Subsequently, in *Tignor v. Parkinson (In re Tignor)*,<sup>153</sup> the Court of Appeals for the Fourth Circuit placed the circuit and Virginia law in accord with the prevailing law under § 541.<sup>154</sup> However, the *Tignor* court noted that the previous cases, such as *Musgrove*, were guided by “strong and sound public policy [that dictates that] a cause of action for personal injury *should* be saved to the debtor alone. [T]his rule ‘. . . is based on principles of public policy to discourage champerty and maintenance.’”<sup>155</sup> Thus, despite the passage of the Bankruptcy Reform Act of 1978, the Fourth Circuit initially abided by an equitable policy that a cause of action in tort for personal injury and the resulting proceeds should belong to the debtor alone so as to avoid increasing the social cost of injury.

In *Musgrove*, the debtor sustained an injury that gave rise to a cause of action for personal injury.<sup>156</sup> The debtor claimed that the cause of action was exempt under § 522(b)(2)(A).<sup>157</sup> However, a Virginia statute precluded the debtor from claiming an exemption under the Federal Bankruptcy Code.<sup>158</sup> Although the debtor filed its petition after the enactment of the Bankruptcy Reform Act of 1978, the court relied upon common law of Virginia that expounded the reasoning of section 70(a)(5) of the Bankruptcy Act of 1898.<sup>159</sup> Because the cause of action was contingent and unliquidated, the debtor could not assign it nor was it subject to the reach of creditors under Virginia State

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<sup>150</sup> 7 B.R. 892 (Bankr. W.D. Va. 1981).

<sup>151</sup> *Id.* at 896.

<sup>152</sup> *Id.* (emphasis added).

<sup>153</sup> 729 F.2d 977 (4th Cir. 1984).

<sup>154</sup> *Id.*

<sup>155</sup> *In re Tignor*, 21 B.R. 219, 221 (E.D. Va. 1982), *vacated in part and remanded*, 729 F.2d 977 (4th Cir. 1984) (quoting, in part, *City of Richmond v. Hanes*, 122 S.E.2d 895, 898 (Va. 1961)).

<sup>156</sup> *Musgrove*, 7 B.R. at 893.

<sup>157</sup> *Id.* That section provides that a state may opt out of federal bankruptcy exemptions and instead force the debtor to rely on state exemptions. 11 U.S.C.A. § 522(b)(1)-(2) (West 2005); *see also* discussion *supra* Part III.

<sup>158</sup> *Musgrove*, 7 B.R. at 895.

<sup>159</sup> *Id.*

law.<sup>160</sup> Therefore, the court permitted the debtor to exempt the cause of action under § 522 by relying on the logic of section 70(a)(5) and the common law of Virginia that held that a cause of action was specifically protected from creditor process.<sup>161</sup>

In *In re Tignor*,<sup>162</sup> the Bankruptcy Court for the Eastern District of Virginia later followed *Musgrove* and concluded that “because an unliquidated and contingent personal injury cause of action is neither assignable nor subject to the reach of creditors’ process under Virginia law it is exempt pursuant to § 522(b)(2)(A).”<sup>163</sup> However, the Court of Appeals for the Fourth Circuit reversed that decision in *Tignor v. Parkinson*.<sup>164</sup> In *Tignor v. Parkinson* the Court of Appeals for the Fourth Circuit corrected the reasoning used by the Virginia bankruptcy courts in *Musgrove* and *Tignor*. There the court agreed that under section 70(a)(5), the cause of action would have been exempt.<sup>165</sup> However, the Bankruptcy Reform Act of 1978 superseded the common law that applied the former Code.<sup>166</sup> Under the Bankruptcy Reform Act of 1978, the cause of action was property of the estate and because Virginia opted out of the federal exemptions the debtor could exempt the cause of action only if Virginia statutory law provided for an exemption.<sup>167</sup> The bankruptcy court had erred in considering the cause of action exempt under the logic of the former section 70(a)(5) because “[e]xemptions are strictly creatures of constitutional and statutory law [under the Bankruptcy Reform Act of 1978] . . . .”<sup>168</sup> The court concluded that:

No statutory exemption was needed under the old Act, because under former [section 70(a)(5)] . . . bodily injury claims did not come into the bankrupt estate in the first instance. [However, w]ith the passage of the [Bankruptcy Reform Act of 1978] . . . , such claims became estate property [and could not be exempted absent a state statute allowing exemption.]<sup>169</sup>

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<sup>160</sup> *Id.* at 896.

<sup>161</sup> *Id.*

<sup>162</sup> 21 B.R. 219.

<sup>163</sup> *Id.* at 222 (citing *Musgrove*, 7 B.R. 892).

<sup>164</sup> *In re Tignor*, 729 F.2d 977 (4th Cir. 1984).

<sup>165</sup> *Id.* at 980.

<sup>166</sup> *Id.* at 981.

<sup>167</sup> *Id.*

<sup>168</sup> *Id.*

<sup>169</sup> *Id.* at 982.

Thus, the court of appeals vacated the opinion of the district court that affirmed the decision of the bankruptcy court and remanded for the assignment of the cause of action to the trustee.<sup>170</sup>

#### 4. *The Logic of Section 70(a)(5) Relied Upon By the Sixth, Seventh, and Fourth Circuits*

Courts that relied on section 70(a)(5) after the adoption of the Bankruptcy Reform Act of 1978 did so with a view towards fairness towards the debtor:

Debtors ought to be allowed to retain sole title to causes of action for personal injuries because those injuries may diminish a debtor's future earning power. Because of the fresh start policy of bankruptcy, it would be unfair and inconsistent to give creditors a bonanza on account of a debtor's injuries . . . .<sup>171</sup>

The reasoning weighed heavily against the creditor and in favor of a fresh start for a debtor:

A debtor's creditor's position should not be improved merely because the debtor has suffered a personal injury. The proceeds from the cause of action should be available to effectuate the debtor's fresh start. It is foreseeable that some debtors might receive windfalls to the detriment of creditors whose claims are discharged . . . . These inequities ought not alter the conclusion reached herein.<sup>172</sup>

However, the trend shifted away from reliance upon section 70(a)(5) when the Ninth Circuit decided *Sierra Switchboard Co. v. Westinghouse Electric Corp.*<sup>173</sup>

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<sup>170</sup> *Id.* The court of appeals held that the proper logic was that the cause of action was property of the estate and could not be exempted absent a state statute exempting the property and not that section 70(a)(5) permitted a common-law exemption because the cause of action could not be assigned under state law. *Id.* at 981–82. In between consideration by the bankruptcy court and the court of appeals, Virginia amended its exemption statute to allow for an unused portion of the homestead exemption to be used to exempt personal property up to \$5000. *Id.* The court of appeals held that the debtor could exempt the cause of action and any proceeds up to that amount under that amendment. *Id.* With its decision in *Cassell v. Krippendorf (In re Cassell)*, No. 93-2246, 1994 U.S. App. LEXIS 10489 (4th Cir. May 11, 1994), the Court of Appeals for the Fourth Circuit superseded its decision in *Tignor*. After *Tignor* the Virginia Legislature passed a statute that specifically exempted personal injury causes of action and later amended that statute to exempt wrongful death recoveries. *Id.* at \*6. Cassell merely clarified that a cause of action for wrongful death could not be exempted from the estate under *Tignor* while a cause of action for personal injury could be exempted under *Tignor*. *Id.* The debtor in *Cassell* could not exempt its cause of action for wrongful death because he filed his petition prior to the relevant statutory amendment. *Id.* at \*9.

<sup>171</sup> *Tignor*, 21 B.R. at 222.

<sup>172</sup> *Id.*

<sup>173</sup> 789 F.2d 705 (9th Cir. 1986).

### 5. *The Ninth Circuit and Sierra: Coming into Accord with § 541*

The initial reliance upon the logic of section 70(a)(5) has given way to general acceptance of § 541 as the standard for including the personal injury cause of action in the bankruptcy estate.<sup>174</sup> In *Sierra*,<sup>175</sup> the Court of Appeals for the Ninth Circuit definitively dealt with the confusion over § 541. The issue in that case was “whether the Bankruptcy Reform Act of 1978 broadened the definition of ‘property’ to include a cause of action for emotional distress where such a cause of action could not be reached by creditors under state law.”<sup>176</sup> The bankruptcy court held that the claim was property of the estate under § 541 regardless of state law and the district court affirmed.<sup>177</sup> In affirming the decision of the district court, the court of appeals pointed to the Fourth Circuit’s decision in *Tignor* and the Sixth Circuit’s decision in *Baker* to illustrate the confusion of § 541 with section 70(a)(5).<sup>178</sup> The *Sierra* court followed the Fourth Circuit’s reading of § 541(a) and held that “regardless of whether a personal injury claim is transferable or assignable under state law, such claims become part of the bankruptcy estate under section 541.”<sup>179</sup> The court relied on the legislative history to conclude that “[b]y adopting a comprehensive definition of property, the Bankruptcy Reform Act [of 1978] reduced the bankruptcy court’s cumbersome reliance on state law analysis for determining property to be included in the estate.”<sup>180</sup> Today, *Sierra* is relied upon in every circuit.<sup>181</sup>

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<sup>174</sup> *See id.*

<sup>175</sup> *See id.*

<sup>176</sup> *Id.* at 707–08.

<sup>177</sup> *Id.* at 707.

<sup>178</sup> *Id.* at 708.

<sup>179</sup> *Id.* at 709.

<sup>180</sup> *Id.* The court refused to address any policy grounds for its decision because the matter was not before the court. *Id.* at 709 n.3.

<sup>181</sup> *See, e.g.,* Resolution Trust Corp. v. SPR Corp. (*In re* SPR Corp.), 45 F.3d 70 (4th Cir. 1995); Gavend v. Hill (*In re* Gavend), No. 93-1494, 1994 U.S. App. LEXIS 13119 (10th Cir. June 2, 1994); Howe v. Richardson, 193 F.3d 60 (1st Cir. 1990); Seward v. Devine, 888 F.2d 957 (2d Cir. 1989); *In re* Cottrell, 876 F.2d 540 (6th Cir. 1989); Cowan v. Fidelity Interstate Life Ins. Co., 89 B.R. 564 (E.D. La. 1988); Lambert v. Fuller Co., 122 B.R. 243 (Bankr. E.D. Pa. 1990); Scarlett v. Barnes, 121 B.R. 578 (Bankr. W.D. Mo, 1990); *In re* Leck, 113 B.R. 500 (Bankr. W.D. Wis. 1990); *In re* Geis, 66 B.R. 563 (Bankr. N.D. Ga. 1986).

### III. EXEMPTIONS: FLESH THAT THE DEBTOR CAN KEEP

#### A. Introduction

The personal injury cause of action is initially included in the bankruptcy estate.<sup>182</sup> Despite the initial inclusion in the bankruptcy estate, the Bankruptcy Reform Act of 1978 and several states allow for an injured bankruptcy debtor to exempt a portion of a personal injury recovery from the estate.<sup>183</sup> Under section 70(a)(5) of the Bankruptcy Act of 1898, a cause of action for personal injury, and thus the subsequent recovery, was not included in the estate absent an express state provision subjecting them to creditor process.<sup>184</sup> However, under the Bankruptcy Reform Act of 1978, “all legal or equitable interests of the debtor in property as of the commencement of the case” belong to the estate, including causes of action for personal injury.<sup>185</sup> Therefore, a debtor must now choose to exempt a personal injury recovery from the estate under state law or federal law in order to keep it for personal use.<sup>186</sup> Such exemptions allow the debtor to keep certain property out of the estate that is necessary for his “fresh start.”<sup>187</sup>

#### B. Exemptions: § 522

Under § 522(b)(1) of the Federal Bankruptcy Code the debtor is permitted to choose either federal exemptions or state exemptions.<sup>188</sup> States may opt out of the federal exemption statute, thereby forcing the debtor to rely only upon the state exemption statute.<sup>189</sup> This scheme of dual exemptions is intended to give a debtor the opportunity to choose the set of exemptions that best protects his interests, especially with regard to large property such as automobiles and homesteads.<sup>190</sup>

The Bankruptcy Reform Act of 2005 allows a debtor to exempt up to \$18,450 of an award “on account of personal bodily injury.”<sup>191</sup> This amount is

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<sup>182</sup> 11 U.S.C.A. § 541 (West 2005); *see also* discussion *supra* Part II.

<sup>183</sup> *Id.* § 522(d)(11)(D).

<sup>184</sup> Bankruptcy Reform Act, § 110(a) (1976) (current version at 11 U.S.C.A. § 541 (2005)).

<sup>185</sup> 11 U.S.C.A. § 541(a)(1) (2005).

<sup>186</sup> *Id.* §§ 541(a), 522(b).

<sup>187</sup> H.R. REP. NO. 95-595, *as reprinted in* 1978 U.S.C.C.A.N. 5963 (1977).

<sup>188</sup> § 522(b)(1).

<sup>189</sup> *Id.* § 541(b)(1).

<sup>190</sup> H.R. REP. NO. 95-595, *as reprinted in* 1978 U.S.C.C.A.N. 5963 (1977).

<sup>191</sup> § 541(d)(11)(D).

not to include recovery for “pain and suffering or compensation for actual pecuniary loss.”<sup>192</sup> The debtor may also exempt “payment in compensation of loss of future earnings of the debtor or an individual of whom the debtor is or was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.”<sup>193</sup> The debtor may exempt its right to receive a payment of “disability, illness, or unemployment benefit[s].”<sup>194</sup> Last, the debtor may exempt any “professionally prescribed health aids.”<sup>195</sup>

### C. State Exemption Statutes

#### 1. No Exemption for Personal Injury Awards

State exemptions range from unlimited exemptions for personal injury regardless of the type of the damages awarded<sup>196</sup> to no exemption for personal injury recoveries.<sup>197</sup> At one end of the continuum of state law of personal injury exemptions are those states that opt out of the federal scheme and do not provide a personal injury or lost future earnings exemption in their own exemption statute.<sup>198</sup> Because the statutes in those states make no specific mention of personal injury claims or their proceeds, courts typically strike down any attempt by a debtor to claim the proceeds as exempt under a more general exemption provision such as for disability payments.<sup>199</sup> Had the legislature intended to exempt such property, it would have promulgated a specific personal injury recovery exemption: “The Legislature’s omission of words of unmistakable meaning which it used in other enactments compels the conclusion that the omission was intentional . . . . [T]he *Statute* to be reviewed

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<sup>192</sup> *Id.* Exactly what the federal exemption allows a debtor to exempt is subject to debate because of this language. The statute negates itself by allowing the debtor to exempt an award on “account of personal bodily injury” but then excluding the elements that make up that award, compensation for pain and suffering and actual pecuniary loss. See Papera, *supra* note 15, for an interesting discussion of the internal contradiction in the federal exemption statute.

<sup>193</sup> § 522(d)(11)(E).

<sup>194</sup> *Id.* § 522(d)(10)(C).

<sup>195</sup> *Id.* § 522(d)(9).

<sup>196</sup> See, e.g., COLO. REV. STAT. § 13-54-102(1)(n) (2005) (unlimited amount unless debt related to injury).

<sup>197</sup> See, e.g., A.R.S. § 33-1126 (2005) (Arizona does not permit exemption for personal injury recoveries and Arizona opts out of federal exemptions).

<sup>198</sup> See, e.g., ALA. CODE §§ 6-10-6 (2005); A.R.S. § 33-1126; DEL. CODE ANN. TIT. 10, § 4902 (2005); FLA. STAT. § 222.25 (2005); IND. CODE § 34-55-10-2(c)(3) (2005) (\$300 exemption for causes of action).

<sup>199</sup> See, e.g., *Richman v. Pratt*, 414 A.2d 1371 (N.J. Super A.D. 1980) (New Jersey exemption statute does not specifically exempt personal injury proceeds therefore they are not exempt under another provision); *In re Hoffpauir*, 125 B.R. 269 (Bankr. D. Ariz. 1990) (Arizona exemption statute does not specifically exempt personal injury proceeds therefore they are not exempt under a disability payments exemption provision).

must contain unequivocal language that the property, claim or asset is exempt . . . . No [s]tatute . . . provides an exemption as to personal injury claims.”<sup>200</sup> Those states are the most restrictive with regard to disallowing the debtor to keep the proceeds of a personal injury award. In these states debtors are in effect left without recourse for their injuries.<sup>201</sup>

## 2. *Limited Exemption for Personal Injury Awards*

Numerous state statutes take a more liberal stance and allow the debtor to exempt a limited amount of a personal injury recovery.<sup>202</sup> The limit of the exemption ranges from \$5000<sup>203</sup> to \$50,000.<sup>204</sup> Some states allow the debtor to exempt an amount necessary to support the debtor and its dependents.<sup>205</sup> Generally, states that permit limited exemption of personal injury awards exclude compensation for pain and suffering and punitive damages from the exemption right.<sup>206</sup> Thus, such statutes permit the debtor to exempt a personal injury award only to the extent that it compensates for actual bodily injury or pecuniary loss.<sup>207</sup> Most states, regardless of what they permit a debtor to exempt from a personal injury award, also allow a debtor to exempt payments for lost future earnings up to an amount needed for support so long as the payments are defined as such in the award.<sup>208</sup> Therefore, to the extent that a debtor can show that a personal injury award is intended to compensate for actual bodily injury and lost future earnings, a debtor may be able to exempt more than the statutory amount.<sup>209</sup> However, in states that do not require specific damages awards from juries, this presents evidentiary issues as to whether a jury intended to compensate for lost future earnings.<sup>210</sup>

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<sup>200</sup> *Hoffpauir*, 125 B.R. at 271–72.

<sup>201</sup> *See, e.g., Wischan v. Adler (In re Wischan)*, 77 F.3d 875 (5th Cir. 1996) (debtor could not exempt personal injury award under Louisiana or federal law).

<sup>202</sup> *See, e.g.*, 31 OKLA. STAT. § 1(A)(21) (2005) (\$50,000).

<sup>203</sup> *See, e.g.*, OHIO REV. CODE ANN. § 2329.66(A)(12)(c) (2006) (\$5000).

<sup>204</sup> *See, e.g.*, OKLA. STAT. § 1(A)(21) (\$50,000).

<sup>205</sup> *See, e.g.*, CAL. CIV. CODE § 704.140(b) (2006) (amount needed for support).

<sup>206</sup> *See, e.g.*, GA. CODE ANN. § 44-13-100(a)(11)(D) (2005) (excludes pain and suffering).

<sup>207</sup> *See id.*

<sup>208</sup> *See, e.g.*, OHIO REV. CODE ANN. § 2329.66(A)(12)(d) (lost future earnings up to amount needed for support).

<sup>209</sup> *See, e.g., id.* § 2329.66(A)(12) (allowing exemption for personal injury award and lost future earnings).

<sup>210</sup> *See, e.g., Wischan v. Adler (In re Wischan)*, 77 F.3d 875 (5th Cir. 1996) (debtor could not exempt personal injury award under Louisiana or federal law); *see also In re Russell*, 148 B.R. 564 (Bankr. E.D. Ark. 1992) (noting the difficulty of proving what a jury intended to compensate for).

### 3. *Unlimited Exemption for Personal Injury Awards*

At the other end of the continuum are the several states that do not limit the debtor's right to exempt personal injury recoveries at all.<sup>211</sup> Those states permit the debtor to exempt an award for personal injury to an unlimited extent regardless of what the award compensates for.<sup>212</sup> The logic underlying these exemptions is that a debtor should not be limited in its recovery because to do so is to limit the compensation to which the debtor is entitled.<sup>213</sup> In *Medill v. State*, the trustee challenged as unconstitutional a statute that permitted the debtor to exempt the entire amount of a personal injury award.<sup>214</sup> The trustee argued that the exemption was excessive because it lacked any language limiting the amount that could be exempted.<sup>215</sup> The court found that the exemption was supported by the principles underlying tort law and that the judicial process of determining tort damages was sufficient to limit the amount of the exemption.<sup>216</sup> The parties would not agree to pay, nor would a jury return an award, that was inherently unreasonable.<sup>217</sup> The judicial process itself was a limit on the exemption.<sup>218</sup> Consequently, any exemption of the award would not be unreasonable nor unconstitutionally vague.<sup>219</sup> Thus, certain states entitle a debtor to an unlimited exemption for a personal injury award.<sup>220</sup>

The *Medill* court poignantly addressed the tension between tort compensation and bankruptcy law and noted the need for exemptions that adequately protect the debtor's interest in an award for personal injury. The court addressed the impropriety of assigning an objective exemption amount: "[While] the legislature can easily define [the value of other personal property], it would be impossible and ludicrous to attempt to put a similar value on the debtor's person . . . ."<sup>221</sup> Because "[t]he goal of bankruptcy relief is to give debtors a fresh start in their financial affairs . . . [e]xemption provisions protect a debtor's fundamental needs by limiting the assets available

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<sup>211</sup> See, e.g., COLO. REV. STAT. § 13-54-102(1)(n) (2005) (unlimited amount unless debt related to injury).

<sup>212</sup> See *id.*

<sup>213</sup> *Medill v. State*, 477 N.W.2d 703, 707 (Minn. 1991).

<sup>214</sup> *Id.* at 704.

<sup>215</sup> *Id.* at 704-05.

<sup>216</sup> *Id.* at 707-08.

<sup>217</sup> *Id.* at 707.

<sup>218</sup> *Id.*

<sup>219</sup> *Id.* at 709.

<sup>220</sup> See, e.g., COLO. REV. STAT. § 13-54-102(1)(n) (2005) (unlimited amount unless debt related to injury).

<sup>221</sup> *Medill*, 477 N.W. 2d at 708.

for distribution to creditors . . . .”<sup>222</sup> As such, “[t]he humane and enlightened purpose of an exemption is to protect a debtor and his family against absolute want by allowing them out of his property some reasonable means of support and education and the maintenance of the decencies and proprieties of life.”<sup>223</sup> The debtor’s interest in its own flesh cannot be levied upon by creditors lest “[t]he debtor who suffers serious personal injury is deprived of using his or her human capital in getting a fresh start.”<sup>224</sup> Moreover, the policies underlying bankruptcy exemptions “apply with even more force to the personal injury right of action exemption because it deals not so much with the debtor’s property, but with the debtor’s human capital. Bankruptcy law protects an individual’s human capital by putting it (in the form of earnings) beyond the reach of creditors.”<sup>225</sup>

4. *Despite Common Purposes of Tort Law and Workers’ Compensation, Many States Do Not Exempt Personal Injury Awards But Many States Do Exempt Workers’ Compensation Awards*

Interestingly, many state statutes and the federal statute provide an exemption for workers’ compensation, unemployment, or medical benefits.<sup>226</sup> Many states that do not provide a specific workers’ compensation benefits exemption have included such benefits in the state’s general disability income benefits exemption.<sup>227</sup> Likewise, pursuant to § 522(d)(10), the following benefits are exempt: “(10) The debtor’s right to receive—(A) a social security benefit, unemployment compensation, or a local public assistance benefit; (B) a veterans’ benefit; (C) a disability, illness, or unemployment benefit . . . .”<sup>228</sup> Courts extend the exemption listed under § 522(d)(10)(C) to workers’ compensation benefits.<sup>229</sup> Social welfare benefits such as workers’ compensation have been exempted to protect the debtor and the debtor’s dependents during the fresh start in the event that the debtor is injured or otherwise unemployable and thus would be hard-pressed to care for himself

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<sup>222</sup> *Id.*

<sup>223</sup> *Id.* (quoting *Poznanovic v. Maki*, 209 Minn. 379, 382 (1941)).

<sup>224</sup> *Id.*

<sup>225</sup> *Id.*

<sup>226</sup> *See, e.g.*, 11 U.S.C.A. § 522(d)(10)(C) (West 2005) (disability or unemployment benefits).

<sup>227</sup> *See, e.g., In re Herald*, 294 B.R. 440 (Bankr. W.D.N.Y. 2003) (relevant New York statute and § 522(d)(10), exempting disability benefits, include workers’ compensation payments); *In re Cain*, 91 B.R. 182 (Bankr. N.D. Ga. 1988) (workers’ compensation benefits exempted under relevant state statute and § 522(d)(10)).

<sup>228</sup> § 522(d)(10).

<sup>229</sup> *See Cain*, 91 B.R. at 183.

and his dependents without supplemental income.<sup>230</sup> However, many states refuse to allow an exemption for personal injury awards despite this common purpose of tort compensation and workers' compensation.<sup>231</sup>

#### IV. JUDICIAL ESTOPPEL: THE LEGAL CHOPPING BLOCK

An unknowing debtor who makes it past the initial bankruptcy filing without having disclosed his cause of action to the bankruptcy court may think that he can still pursue the action and keep the proceeds for himself after the bankruptcy is discharged. However, when a debtor files bankruptcy and fails to disclose his personal injury cause of action as an asset of the estate, and then files suit on his own behalf after having already filed bankruptcy, insurance companies and other defendants to the suit may be able to raise a complete defense, eliminate the plaintiff-debtor's recovery and revert the cause of action to the bankruptcy estate.<sup>232</sup> This typically is done by filing a motion for summary judgment on the grounds that the plaintiff-debtor is judicially estopped from pursuing a cause of action that he earlier denied existed by omitting the asset from the bankruptcy schedule of assets.<sup>233</sup> The plaintiff-debtor is not permitted to first deny by omission the existence of the cause of action, and then later affirmatively claim the existence of the action by filing suit.<sup>234</sup> As such, under the equitable doctrine of judicial estoppel, insurance companies and defendants avoid liability, general unsecured creditors receive a larger pro rata payout and debtors lose their chance to be compensated under tort law. Ironically, this may increase costs to those same entities when the under-compensated debtor seeks new credit or social welfare support.

Judicial estoppel is an equitable doctrine that requires that the debtor previously denied the existence of a cause of action by failing to list the cause of action on his schedule of assets.<sup>235</sup> Because under § 541(a) all interests of the debtor, including causes of action, are property of the estate subject to claimed exemptions, the debtor must list such property on his schedule of assets and exemptions or risk forfeiting the entirety of the property to the

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<sup>230</sup> *Gagne v. Christians*, 172 B.R. 50, 53–55 (Bankr. D. Minn. 1994).

<sup>231</sup> *See, e.g., Richman v. Pratt*, 414 A.2d 1371 (N.J. Super App. Div. 1980) (New Jersey exemption statute does not specifically exempt personal injury proceeds therefore they are not exempt under another provision).

<sup>232</sup> *See generally DeLeon v. Comcar Indus., Inc.*, 321 F.3d 1289 (11th Cir. 2003); *Burnes v. Pemco Aeroplex, Inc.*, 291 F.3d 1282 (11th Cir. 2002).

<sup>233</sup> *See* FED. R. BANKR. P. 7056; *DeLeon*, 321 F.3d at 1291.

<sup>234</sup> *Id.*

<sup>235</sup> *See Burnes*, 291 F.3d at 1285.

trustee.<sup>236</sup> A debtor who files suit based on a cause of action that he previously failed to list on his schedule of assets has acted in two judicially inconsistent ways: the debtor denied the existence of the cause of action on his schedule of assets, and later affirmed the existence of the cause of action by filing suit. If the debtor acted in such a way to demonstrate bad faith or the desire to make a mockery of the judiciary by taking advantage of said inconsistent legal positions, then the debtor is judicially estopped from pursuing his cause of action.<sup>237</sup>

Judicial estoppel prevents litigants from abusing the judiciary.<sup>238</sup> The justification for applying judicial estoppel is that a litigant should not be permitted to benefit from deceiving the judiciary by assuming two inconsistent positions.<sup>239</sup> Otherwise, litigants would be able to take inconsistent positions and use the judicial system to gain advantages over one another by first denying and later affirming the existence of a lawsuit. Despite the apparent benefit to opposing litigants, the doctrine is not actually intended to protect litigants from abusive litigation.<sup>240</sup> The type of contradiction that the application of judicial estoppel seeks to avoid is deliberate and schemed manipulation which is aimed at taking advantage of proceedings for personal gain.<sup>241</sup> Where the bankrupt knows of his cause of action and has motive to conceal it, a court has held that this is deliberate manipulation.<sup>242</sup>

Judicial estoppel is a federal common-law doctrine but its availability rests on the time when state law recognizes the accrual of the cause of action. Federal and state courts consistently apply the doctrine where the cause of action clearly arose before or during the bankruptcy filing, and the debtor failed to list the asset, receives a discharge, and then later files suit on the cause of action.<sup>243</sup> Federal courts generally get jurisdiction over the personal injury proceedings, usually a motion for summary judgment,<sup>244</sup> as a core proceeding,<sup>245</sup> either because the debtor seeks to reopen his bankruptcy and

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<sup>236</sup> 11 U.S.C.A. § 541 (West 2005); FED. R. BANKR. P. 1007.

<sup>237</sup> *Burnes*, 291 F.3d at 1285.

<sup>238</sup> *Id.*

<sup>239</sup> *Id.*

<sup>240</sup> *Id.* at 1285–86.

<sup>241</sup> *Id.* at 1285.

<sup>242</sup> *See, e.g., id.* at 1282.

<sup>243</sup> *See, e.g., DeLeon v. Comcar Indus., Inc.*, 321 F.3d 1289; *Burnes*, 291 F.3d 1282.

<sup>244</sup> FED. R. BANKR. P. 7056.

<sup>245</sup> 11 U.S.C.A. § 157 (West 2005).

amend his schedule of assets,<sup>246</sup> or because the cause of action is property of the estate from the outset.<sup>247</sup>

The application of judicial estoppel to bar a plaintiff from pursuing a cause of action is widely criticized because it takes from the debtor his sole recourse against a negligent defendant,<sup>248</sup> or because it gives a windfall to the wrongdoer defendant who successfully raises the defense of judicial estoppel.<sup>249</sup> Despite criticism, judicial estoppel exists on the surgeon's tray, alongside § 541 and state exemption statutes, as another instrument with which creditors can excise the flesh of injured debtors. Unbeknownst to them, the creditors and insurance companies raising the defense of judicial estoppel may only be increasing costs to themselves and society in the future.

## V. THOSE TOUGH-SKINNED CREDITORS WANT A PIECE OF FLESH, TOO: ADDRESSING THE COUNTERARGUMENTS

### A. Introduction

Creditors no doubt have an interest in the debtor's assets.<sup>250</sup> To the extent that a debtor is entitled to exempt property from the estate, an unsecured creditor may not use that property in order to satisfy its claims.<sup>251</sup> Thus, it is in the interest of creditors that an award for personal injury be included in the bankruptcy estate because it increases the assets in the estate, and the creditors will be in a better position to receive an adequate payout when the assets in the estate are distributed.<sup>252</sup> Therefore, while a debtor hopes to exempt a personal injury award from the estate, creditors and the trustee in bankruptcy often object to the claimed exemption.<sup>253</sup> To the extent that an exemption statute specifies that an asset must be traceable to a specific source, is limited in amount, or does not exist for personal injury recoveries, creditors and trustees often win these objections when juries return large, nonspecific damage

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<sup>246</sup> See, e.g., *Period Homes, Ltd. v. Wallick*, 275 Ga. 486 (2002).

<sup>247</sup> See generally § 541.

<sup>248</sup> See generally Theresa M. Beiner & Robert B. Chapman, *Take What You Can, Give Nothing Back: Judicial Estoppel, Employment Discrimination, Bankruptcy, and Piracy in the Courts*, 60 U. MIAMI L. REV. 1 (2005) (cautioning against use of judicial estoppel to bar employment discrimination cases).

<sup>249</sup> See, e.g., *Taylor v. Comcast Cablevision of Ark., Inc.*, 252 F. Supp. 2d 793, 798 (E.D. Ark. 2003).

<sup>250</sup> §§ 502 (allowance of claims) and 541 (bankruptcy estate).

<sup>251</sup> *Id.* § 522(c).

<sup>252</sup> *Id.* §§ 726, 727.

<sup>253</sup> *Id.* § 522(l).

awards.<sup>254</sup> Consequently, a portion of personal injury awards are often used to compensate the creditors of injured debtors.<sup>255</sup>

*B. Counterargument: Creditors Are Entitled to the Largest Estate Possible*

Despite the creditors' interests in having the largest bankruptcy estate possible, the creditors' positions should not be improved at the expense of an injured debtor. Due to bankruptcy law's fresh start policy,

it would be unfair and inconsistent to give creditors a bonanza on account of a debtor's injuries . . . . A debtor's creditor's position should not be improved merely because the debtor has suffered a personal injury. The proceeds from the cause of action should be available to effectuate the debtor's fresh start. It is foreseeable that some debtors might receive windfalls to the detriment of creditors whose claims are discharged . . . .<sup>256</sup>

Bankruptcy law already recognizes that in some situations it is inequitable to allow a creditor to improve its position at the expense of other parties in interest.<sup>257</sup> An injured debtor that is cheated out of an award meant to ensure that it can support itself may be forced to rely on other means of support after its meager exemption amount is exhausted: "[A]n uncompensated claim for personal injury may seriously complicate the injured's ability to function in the future."<sup>258</sup> As such, the debtor may seek refuge in social welfare programs and may once again become insolvent. Therefore, the inequities to creditors "ought not alter the conclusion" that a debtor is entitled to the proceeds of a personal injury action.<sup>259</sup>

<sup>254</sup> See, e.g., *Mercer v. Monzack (In re Mercer)*, 53 F.3d 1 (1st Cir. 1995) (illustrating attempted exemption of a nonspecific award and objections thereto).

<sup>255</sup> *Id.*

<sup>256</sup> *In re Tignor*, 21 B.R. 219, 222 (Bankr. E.D. Va. 1982), *vacated and rev'd in part*, 729 F.2d 977 (4th Cir. 1984).

<sup>257</sup> See, e.g., § 1129(a)(7) (best interests test for confirmation of a chapter 11 plan does not allow a creditor to improve its position over other creditors as compared to a chapter 7 payout plan).

<sup>258</sup> *In re Schmelzer*, 350 F. Supp. 429, 436 (S.D. Ohio 1972).

<sup>259</sup> *Tignor*, 21 B.R. at 222. The question is:

[W]ho shall benefit from the potential windfall, if a claim for personal injuries can be so characterized. When the question is posed in these terms, it should be clear that we have done no more today than to recognize that the Act, which contains a presumption in favor of the [already financially shaky] bankrupt, was enacted for the protection of debtors, and that its underlying policies favor the bankrupt.

*Schmelzer*, 350 F. Supp. at 438 (referring to the Bankruptcy Act of 1898). The policies under the current Act are similar to those under the former Act. See *In re Luster*, 981 F.2d 277, 280 (7th Cir. 1992) ("[I]t is hard to

*C. Counterargument: Creditors Will Seek to Offset a Low Payout in Bankruptcy by Increasing Interest Rates*

It is unlikely that not including a personal injury award in the bankruptcy estate will cause creditors to seek compensation from future debtors to offset this loss. Credit-granting institutions are often held by holding companies engaged in large-scale banking and nonbanking operations.<sup>260</sup> Other assets of those companies will likely offset the credit risk taken by large banks when a bankrupt debtor leaves only a fractional payout to satisfy its debts.<sup>261</sup> In addition, more expansive participation by bank-holding companies in increasingly more diverse profit-making activities further offsets any risk.<sup>262</sup> Furthermore, credit-granting institutions such as banks are already required to account for credit risk in calculating their capital reserve and consequent lending limits.<sup>263</sup> Therefore, preventing a creditor from improving its position in bankruptcy on a pro rata basis at the expense of the debtor is unlikely to adversely affect the remainder of the debt-bearing public. In fact, because an injured debtor would be ensured a fresh start and adequate compensation for its injuries if permitted to exempt its award, society and future debtors may be better off because credit institutions would not suffer increased credit risk due to desolate injured debtors and would thus not need to increase interest rates or otherwise guard against higher risk.

*D. Counterargument: An Award for Prepetition Personal Injury Is Akin to Prepetition Income and Should Be Included in the Estate*

Tort compensation is often a substitute for earnings lost due to the debtor's injuries.<sup>264</sup> Jury instructions for damages for personal injury specifically

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isolate a 'bankruptcy policy' distinct from the terms of the 1898 Act and 1978 Code. 'Bankruptcy policy' does not exist in the abstract; the term is a shorthand for rules and the implications they create. When construing ambiguities in bankruptcy statutes, courts consider goals that infuse the structure of the laws—goals such as preventing a race among creditors that reduces the total value of the estate, distributing assets according to contractual and statutory entitlements, and providing natural persons with "fresh starts" so that they again can claim the rewards of their labor.")

<sup>260</sup> JONATHAN R. MACEY ET AL., *BANKING LAW AND REGULATION* 119 (3d ed. 2001).

<sup>261</sup> *Id.* at 49.

<sup>262</sup> *Id.* at 49, 119.

<sup>263</sup> *Id.* at 277–78, 281–90.

<sup>264</sup> See generally Stephen D. Sugarman, *Doing Away With Tort Law*, 73 CAL. L. REV. 555 (1985); see also Kenneth S. Abraham, *What is a Tort Claim? An Interpretation of Contemporary Tort Reform*, 51 MD. L. REV. 172, 173–74 (1992) ("[Tort] reforms import into tort law some of the more appealing . . . features of non-tort compensation systems—workers' compensation . . . and private and social insurance . . . . Indeed, the

reference lost income as an element of tort recovery.<sup>265</sup> Thus, a tenable argument can be made that an award for personal injury compensates the debtor for prepetition lost earnings and therefore should be part of the bankruptcy estate under § 541(a)(6).<sup>266</sup> However, income substitutes as opposed to actual income earned are distinguished in tax law and workers' compensation law.

Monetary awards that substitute for lost income are actually recognized as a special exception from the creditor process in many states and in federal bankruptcy.<sup>267</sup> For instance, an award for workers' compensation that replaces the lost income of an injured worker is exempted from the bankruptcy estate.<sup>268</sup> Such income, had it been earned through employment by the debtor prior to the petition, would normally be included in the bankruptcy estate.<sup>269</sup> However, because the income substitute is awarded as a result of the debtor's injuries, the payments receive special treatment so as to avoid income interruption and the consequent drain on society that an injured debtor would have were it not adequately compensated for injuries.<sup>270</sup> In addition, awards for workers' compensation are exempt from taxation.<sup>271</sup> In fact, the "amount of any damages . . . received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness" do not count as gross income.<sup>272</sup> Therefore, any argument that an award for personal injury arising prepetition should be regarded as prepetition income that should be included in the bankruptcy estate fails in light of the wide recognition that income substitutes are exempt from taxes and creditor process elsewhere under the law.

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evolving conception of a tort claim reflects the . . . standardization of recovery that is at the core of health and disability insurance and other non-tort compensation systems.”).

<sup>265</sup> See, e.g., Eleventh Circuit Pattern Jury Instruction § 1.1, at 455–58 (2005) (negligence).

<sup>266</sup> Compensation for the services of the debtor is included in the bankruptcy estate only if the debtor became entitled to it prepetition. 11 U.S.C.A. § 541(a)(6) (West 2000).

<sup>267</sup> See, e.g., § 522(d)(11)(E) (lost earnings exemption).

<sup>268</sup> *Id.* § 522(d)(10)(C) (exempting disability or unemployment benefits).

<sup>269</sup> *Id.* § 541(a).

<sup>270</sup> *Gagne v. Christians*, 172 B.R. 50, 53–55 (Bankr. D. Minn. 1994).

<sup>271</sup> 26 U.S.C. § 104(a)(1) (2000).

<sup>272</sup> *Id.* § 104(a)(2).

*E. Counterargument: Because of the Subjective Nature of Punitive Damages and Pain and Suffering, Such an Award Should Not Be Exempt from the Estate*

While damages for lost income are readily calculable and serve a definite purpose, damages for intangible losses are difficult to calculate and serve more amorphous purposes.<sup>273</sup> This has formed the basis for the argument that such awards should not be exempt from the bankruptcy estate.<sup>274</sup> In fact, personal injury awards are often subject to statutory caps already.<sup>275</sup> Many states have enacted statutory caps on punitive damages and pain and suffering.<sup>276</sup> These caps seek to limit damages that are difficult to determine, such as those for mental anguish or those inflicted maliciously.<sup>277</sup> Many bankruptcy exemption statutes further limit recovery for punitive damages and pain and suffering for precisely the same reason.<sup>278</sup> However, there is no reason why a creditor as opposed to the debtor should be given a windfall as a result of a large award for pain and suffering or punitive damages.<sup>279</sup> In fact, because tort law aims to compensate victims for their loss<sup>280</sup> and because bankruptcy aims to give a debtor a fresh start,<sup>281</sup> an injured debtor should not be divested of his award for punitive damages or pain and suffering. Punitive damages awards and pain and suffering awards are subjective, personal, and already subject to state tort reform statutes that limit them in amount.<sup>282</sup> In addition, such awards are already judicially tested and peer-approved as they are rendered by a competent jury. To the extent that legislatures have already determined the

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<sup>273</sup> Pain and suffering compensates the debtor for the pain of having to cope with an injury while punitive damages aim to deter tortfeasors' bad behavior. RESTATEMENT (SECOND) OF TORTS § 901 (2006).

<sup>274</sup> See, e.g., *In re Keyworth*, 47 B.R. 966 (Bankr. D. Colo. 1985) (punitive damages are exemplary and thus not exempt); see also 11 U.S.C.A. § 522(d)(11)(D) (West 2005) (punitive damages and pain and suffering not exempt).

<sup>275</sup> See, e.g., COLO. REV. STAT. § 13-21-102.5 (2005) (\$250,000 cap on noneconomic damages).

<sup>276</sup> *Id.*

<sup>277</sup> See, e.g., CAL. CIV. CODE § 1431.2(b)(2) (2006) (defining noneconomic damages as "subjective non-monetary losses including, but not limited to, pain, suffering, inconvenience, mental suffering, emotional distress, loss of society and companionship, loss of consortium, injury to reputation and humiliation").

<sup>278</sup> See, e.g., 11 U.S.C.A. § 522(d)(11)(D) (West 2005) (excluding pain and suffering and punitive damages from exemption).

<sup>279</sup> See, e.g., *In re Schmelzer*, 350 F. Supp. 429, 438 (S.D. Ohio 1972) ("[T]he question is who shall benefit from the potential windfall, if a claim for personal injuries can be so characterized. When the question is posed in these terms, it should be clear that we have done no more today than to recognize that the Act, which contains a presumption in favor of the [already financially shaky] bankrupt, was enacted for the protection of debtors, and that its underlying policies favor the bankrupt.").

<sup>280</sup> DOBBS, *supra* note 11, § 1.

<sup>281</sup> EPSTEIN ET AL., *supra* note 25, § 1-2.

<sup>282</sup> See, e.g., COLO. REV. STAT. § 13-21-102.5 (2005); CAL. CIV. CODE § 1431.2(b)(2) (2006).

limits of subjective awards in tort and to the extent that such awards are judicially tested and peer-approved, the debtor should be favored in light of the fundamental principles of compensation and bankruptcy, and such awards should not belong to the estate.

## VI. A SOLUTION: SUTURING THE WOUNDS OF INJURED DEBTORS

### A. *The Need for a Solution*

Neither the federal exemption scheme nor the majority of state exemption schemes adequately protect a debtor's interest in a personal injury award. It is unlikely that a lump sum of \$18,450,<sup>283</sup> or even less,<sup>284</sup> and payments for lost future earnings<sup>285</sup> will adequately cover the costs of medical treatment, provide the debtor with adequate piece of mind for having to cope with a lost body part, provide support for the debtor's family, and take into account the value of the lost productivity of the debtor.<sup>286</sup> This is especially true for the 45.8 million Americans who do not have health insurance.<sup>287</sup> An injured debtor who is forced to disgorge his personal injury award to his creditors<sup>288</sup> and is permitted only to retain a fraction of the subsequent recovery<sup>289</sup> is likely to need future support in the form of social welfare, additional credit lines, and, in the event they have insurance, continuing insurance benefits to help pay for medical treatment. This means that the debtor becomes a drain on public funds, incurs future debt and perhaps files bankruptcy again, and contributes to the haste with which insurance premiums increase. In short, the injured debtor is forced to repay its debts with money better left to compensating the debtor for his injuries.

The federal bankruptcy exemption or state exemptions do not comport with the principles of compensation underlying tort law.<sup>290</sup> A debtor suffers pain and suffering, physical loss, lost future earnings, loss of productivity, and the

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<sup>283</sup> 11 U.S.C.A. § 522(d)(11)(D) (West 2005).

<sup>284</sup> See, e.g., OHIO REV. CODE ANN. § 2329.66(A)(12) (2006) (\$5000 exemption).

<sup>285</sup> 11 U.S.C.A. § 522(d)(11)(E) (West 2005).

<sup>286</sup> National Safety Council, *supra* note 10. Injuries cited include automobile accidents, home injuries, public injuries and work injuries. *Id.*

<sup>287</sup> U.S. Census Bureau, U.S. Department of Commerce, *Income, Poverty, and Health Insurance Coverage in the United States: 2004*, 60 (2005), available at <http://www.census.gov/prod/2006pubs/p60-23/pdf>.

<sup>288</sup> § 541(a).

<sup>289</sup> See, e.g., *id.* § 522(d)(11)(D) (\$18,450 federal exemption).

<sup>290</sup> See discussion *supra* Part I.B.

cost of medical expenses.<sup>291</sup> A debtor may only exempt the portions of an award for personal injury specified in the federal exemption statute, i.e., that portion that compensates for actual bodily injury.<sup>292</sup> While the debtor may exempt payments made to compensate for lost future earnings,<sup>293</sup> medical devices,<sup>294</sup> and disability or unemployment benefits,<sup>295</sup> to be exempt the payments need to be “traceable to,”<sup>296</sup> “on account of,”<sup>297</sup> or in a form identifiable to one of the categories listed in the statute.<sup>298</sup> Thus, to the extent that a jury award does not allocate a specific amount for each of the categories in an exemption statute, the debtor may be left with a general lump sum award for pecuniary and nonpecuniary losses and thus resigned to a single exemption for loss on account of bodily injury or no exemption at all under § 522(d)(11)(D).<sup>299</sup> While many of the states are more generous than the federal statute, in light of the costs of personal injuries, the statutes still do not adequately account for the losses to a debtor.<sup>300</sup>

Furthermore, the lack of an exemption for personal injury recoveries seems to be at odds with the presence of an exemption for disability benefits.<sup>301</sup> Just like including workers’ compensation awards in the bankruptcy estate is inconsistent with the policies underlying workers’ compensation,<sup>302</sup> including personal injury recoveries in the bankruptcy estate is inconsistent with principles of tort compensation. A primary purpose of workers’ compensation is to prevent society from bearing the costs of an injured worker.<sup>303</sup> If bankruptcy law recognizes the importance of exempting workers’ compensation to decrease social costs of injury and help the debtor get a fresh start, bankruptcy law should place the same importance on tort recoveries.

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<sup>291</sup> See discussion *supra* Part I.A–B.

<sup>292</sup> § 522(d)(11)(D).

<sup>293</sup> *Id.* § 522(d)(11)(E).

<sup>294</sup> *Id.* § 522(d)(9).

<sup>295</sup> *Id.* § 522(d)(10)(C).

<sup>296</sup> *Id.* § 522(d)(11)(D).

<sup>297</sup> *Id.*

<sup>298</sup> See generally *id.* § 522.

<sup>299</sup> See, e.g., *In re Russell*, 148 B.R. 564 (Bankr. E.D. Ark. 1992) (debtor could not exempt general jury award as payment on account of loss of future earnings).

<sup>300</sup> National Safety Council, *supra* note 10. For instance, the National Safety Council estimates that the cost to society of each personal injury resulting from automobile accidents ranges from \$19,600 for noncapacitating evident injuries to \$60,500 for incapacitating injuries. *Id.* The federal exemption of \$18,450 is meager by comparison. *Id.*

<sup>301</sup> See generally § 522(d)(10)(C).

<sup>302</sup> *Gagne v. Christians*, 172 B.R. 50, 53–55 (Bankr. D. Minn. 1994).

<sup>303</sup> *Id.*

Thus, a solution is needed to bring bankruptcy exemptions into accord with principles of tort compensation, social welfare, and the long-term interests of creditors.

*B. Balancing the Needs of Debtors with the Needs of Creditors*

There needs to be a balance between the interests of debtors and creditors that favors returning the debtor to solvency, avoiding future loss to creditors, and eventual drain on social resources. This can be accomplished by legislation that honors the principles underlying tort compensation—that an injured individual should be returned to his pre-injury condition and compensated for his losses<sup>304</sup>—and the principles of bankruptcy—that debts should be satisfied and discharged and the debtor should be given a fresh start.<sup>305</sup> The current system of bankruptcy exemptions does not achieve an appropriate balance because it does not honor these policies in a balanced manner.

The current system weighs too heavily in favor of creditors at the expense of injured debtors.<sup>306</sup> In the case of injured debtors, the current system of estate formation and exemptions fails to take into account the interests of debtors and the costs to society and future creditors of stripping the injured debtor of a personal injury award.<sup>307</sup> Debtors are permitted fixed exemptions that are arbitrary and meager even when they have suffered catastrophic losses that are far more costly.<sup>308</sup> Debtors are given only a fraction of what they need to survive and remain solvent after bankruptcy.<sup>309</sup> Thus, under the current exemptions available to a debtor, the concept of a fresh start is largely illusionary because the balance is in favor of compensating creditors.<sup>310</sup>

On the other hand, entirely excluding a personal injury award from the bankruptcy estate would place it beyond the reach of creditors.<sup>311</sup> Excluding property from the bankruptcy estate rarely is done.<sup>312</sup> Rather, with the Bankruptcy Reform Act of 1978, most property is included in the estate and

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<sup>304</sup> See discussion *supra* Part I.A–B.

<sup>305</sup> See discussion *supra* Part I.C.

<sup>306</sup> See discussion *supra* Part I.C.

<sup>307</sup> See discussion *supra* Part I.C.

<sup>308</sup> See discussion *supra* Part III.

<sup>309</sup> See generally National Safety Council, *supra* note 10.

<sup>310</sup> See discussion *supra* Part I.C.

<sup>311</sup> See discussion *supra* Parts II, III.

<sup>312</sup> See discussion *supra* Part II.

then an exemption is claimed.<sup>313</sup> Furthermore, allowing a debtor to keep an entire personal injury award without affording creditors a chance to object is inherently unfair. For example, a hospital that provided emergency medical treatment to a bankrupt debtor has an interest in any personal injury award arising from the injury it treated. Allowing a debtor to keep the entirety of a personal injury award of the estate would preclude such a creditor from claiming an interest in the award.<sup>314</sup> Thus, while the current scheme favors creditors, allowing a debtor to keep the entirety of a personal injury award would completely contravene the purpose of bankruptcy to ensure that creditors can collect outstanding debts.<sup>315</sup>

### C. A Solution

Modifications to the current exemption scheme will allow bankruptcy law to better protect the interests of debtors, creditors, and society. However, requiring all states to comply with a standard exemption scheme would eliminate states' rights to statutory experimentation,<sup>316</sup> while allowing states the freedom to exempt all or none of a personal injury award has led to the inequities addressed here. Instead, I suggest a presumptive federal exemption for personal injury awards. The federal exemption statute would exempt the entirety of a personal injury award regardless of the type of damages awarded. Each state would still be permitted to enact their exemption statutes for property other than personal injury awards. The debtor would have the opportunity to choose either the state or federal exemptions for property other than personal injury awards but no state would be permitted to exempt out of the federal personal injury exemption. The presumption in favor of the federal exemption for personal injury awards would, however, be rebuttable. Creditors and trustees would have the opportunity to rebut the presumption upon a showing of inherent unfairness to a specific creditor. The only way that a creditor or trustee could raise a successful objection to the use of the mandatory personal injury federal exemption would be to make a showing that the federal exemption would be inherently unfair to a specific creditor in light of the facts of the case, e.g., where there is a creditor like a medical provider that has a vested interest in the personal injury award. Once such a showing is made the court would fashion an appropriate exemption based on the facts of

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<sup>313</sup> See discussion *supra* Part III.

<sup>314</sup> See discussion *supra* Parts II, III.

<sup>315</sup> See discussion *supra* Part I.C.

<sup>316</sup> See generally *Crist v. Bretz*, 437 U.S. 28 (1978) (state experimentation cannot be sacrificed for uniformity).

the case. Absent such a showing, there would be a strong presumption in favor of the federal personal injury exemption. Under no circumstances would a general objection on the grounds that the pro rata payout to unsecured creditors as a whole was unfair suffice to overcome the presumption. The objection would need to be based on harm to a specific creditor.

The risk of abuse and inequity under a revised statute could be minimized by the use of certain safeguards that would guarantee that creditors and debtors had incentives to act in the best interest of all parties-in-interest. For instance, the risk that a creditor would object to the use of the federal exemption in order to force a smaller, judicially-fashioned exemption upon the debtor could be minimized by requiring that the judicially-created exemption be calculated on a sliding percentage scale as opposed to subject to a set monetary cap. For instance, if the award were between zero and \$100,000, the debtor could exempt 70% of the award, the remaining 30% to be split pro rata amongst the creditors. If the award were between \$100,000 and \$500,000, the debtor could exempt 85%, the remaining 15% to be split pro rata amongst the creditors, and so on. This would provide the harmed creditor with a substantial portion of the award, and provide the debtor at least a portion of the tort compensation to which he was entitled. Of course, any creditor who sought to displace the mandatory federal exemption with a judicial exemption would only be entitled to receive up to the value of its claim, the remainder of the award going to the debtor.

Any further risk of abuse by creditors could be minimized by giving bankruptcy judges the discretionary authority to overrule any objection and permit the debtor the use of the presumptive federal exemption. The judge also would allow and consider evidence on the issue of an injured debtor's need to be compensated to the fullest extent possible to avoid future loss to itself and society. This evidence could include medical evaluations that show the debtor's need for ongoing treatment, the mental strain of coping with the injury, in addition to any evidence that showed the likelihood or not that a debtor would be forced to rely on social welfare programs and incur more debt for support in light of his injury. If the judge believes that the interests of the debtor and society would be best served by allowing unlimited exemption, the judge could use the federal exemption despite any inequity to a creditor. In short, a hearing should be held on the amount of exemption to which a debtor is entitled.

Finally, to assure that the exemption for personal injury awards is considered in a light favorable to debtors, bankruptcy judges should bear in mind that anything other than an unlimited exemption limits the amount of compensation that a court already determined a debtor was entitled to under tort law. To the extent that a court or jury hearing a personal injury cause of action already determined that a debtor is entitled to a set amount of compensation and punitive damages, a bankruptcy judge should largely defer to the trial court on the issue. Absent clear and convincing evidence that a creditor would suffer irreparable harm, a bankruptcy judge should defer to the judgment of a competent court, jury, or representatives of the parties to a suit for personal injury by honoring the amount awarded or agreed to be paid in settlement of the claim for personal injury. In the event that the federal exemption for a personal injury award is used by the bankruptcy judge, the exemption would only be limited by the statutory caps on pain and suffering and punitive damages in the state where the cause of action accrued. This assures some limit on the debtor's exemption while guaranteeing that he receives what he needs.

An ideal exemption system would embody tort compensation principles, language that is not excessively restrictive of a debtor's interest in a personal injury recovery, a mandate that a bankruptcy judge critically assess the respective equities in giving a debtor an unlimited exemption and allowing a creditor a court-tailored exemption that limits the debtor's recovery, the freedom of states to enact their own exemptions, and an opportunity for creditors to object to the liberally drafted unlimited federal exemption statute in favor of a more modest judicially-created, fact-specific exemption. Such a system would afford the debtor the compensation to which he is entitled under tort law more often than the current system.

Such a statute might begin like the current § 522(d)(11), however, with a more general and less confusing description of what is exempt. In relevant part, the statute would state:

The following property may be exempted under this section: The debtor's right to receive, or an award that is traceable to, a lump sum payment or installment payments made pursuant to an amount judicially determined as necessary by a court hearing the cause of action in personal injury to compensate the debtor for its tangible and intangible losses, provided that (1) upon a showing of clear and convincing evidence by a party in interest that it will be irreparably harmed by such an exemption, and (2) upon a finding by the bankruptcy judge to the same effect, the bankruptcy judge will hold a

hearing to determine the amount of the exemption. In determining the amount of the exemption the court shall consider the totality of circumstances, and the extent to which the parties will suffer harm, including but not limited to harm visited upon not only the parties but harm visited upon future creditors, society, and social welfare institutions, in light of the fact that using a court-fashioned exemption the debtor will receive less than the amount that a competent court had previously awarded to him for his injuries. Absent such a showing, the federal exemption shall be used.

A clear and unambiguous statute (*if* that is possible) would eliminate the need to structure settlements to mimic exemption categories such as lost income or disability payments, afford the debtor the required compensation, and allow creditors the opportunity to object to the exemption by showing evidence that the unlimited federal exemption would harm their interests. In the aggregate, this would achieve an acceptable balance between the interests of the debtor and creditors because it would place the burden on the creditors while providing a presumption that the debtor is entitled to a fully exempted award. Furthermore, because the federal exemption statute would remain unchanged with regard to property other than personal injury awards, creditors would still be entitled to payouts roughly equivalent to those received under the present statute. The only change would be that debtors are favored with regard to personal injury awards.

#### CONCLUSION

The concept of a fresh start for an injured debtor in bankruptcy is appositional absent adequate compensation for a personal injury. When an injured individual is not adequately compensated, he cannot bear the costs of injury and in turn the costs to society increase. Monetary awards in personal injury replace human capital so that society does not need to bear that cost. To the extent that bankruptcy takes this human capital to compensate creditors, uninsured debtors are forced to rely on means other than a personal injury award to pay for medical expenses and insured debtors and uninsured debtors alike are resigned to other means to cope with their pain and support themselves and their families and society bears the costs of these alternative means of support. In turn, the costs of healthcare rise, social welfare programs are burdened, and social problems arise if a desolate debtor is forced to turn to crime or drugs to cope with its loss. Absent a solution that takes into account the interests of debtors in being compensated under the principles of tort law,

bankruptcy increases the social costs of personal injuries and fails to meet the goal of providing an injured debtor with a fresh start in order to benefit creditors. This is not acceptable because “[i]t is not, and never has been, the policy of the law to coin into money for the profit of his creditors, the bodily pain, mental anguish or outraged feelings of a bankrupt.”<sup>317</sup>

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<sup>317</sup> *In re Tignor*, 21 B.R. 219, 222 (Bankr. E.D. Va. 1982) (quoting *Sibley v. Nason*, 196 Mass. 125, 130 (Mass. 1907)).

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