

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF ALABAMA

In Re

ANTHONY H. CONWAY
SUSAN E. CONWAY

Case No. 03-11200-MAM-7

Debtors.

**ORDER GRANTING DEBTORS' MOTION FOR INSTRUCTIONS AND REQUIRING
DEBTORS TO AMEND THEIR SCHEDULE CLAIMING EXEMPTIONS**

Melissa W. Wetzel, Mobile, Alabama, Attorney for the Debtors
Joseph O. Verneuille, Jr., Mobile, Alabama, Trustee

This matter is before the Court on the Conways' motion for instructions regarding an asset discovered postpetition. The Court has jurisdiction to hear this matter pursuant to 28 U.S.C. §§157 and 1334 and the Order of Reference of the District Court. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2) and the Court has authority to enter a final order. For the reasons indicated below, the Court finds that the debtors must amend their schedule claiming exemptions.

FACTS

The debtors, Anthony and Susan Conway, filed a chapter 7 bankruptcy case in this Court on February 27, 2003. Approximately one year before the Conways' filing, Ms. Conway suffered a heart attack. She briefly returned to work at the Mobile Infirmary ("Infirmary") before undergoing open heart surgery in August 2003. After the surgery, Ms. Conway's physician advised her not to return to work.

The Conways' bankruptcy schedules reflected that Ms. Conway was not receiving any income from the Infirmary when they filed their chapter 7 case. However, they did list a potential social security disability claim as exempt property of the estate. On March 1, 2003,

Ms. Conway became eligible to receive disability payments under the Infirmary's long term disability policy. The policy is part of Ms. Conway's compensation and benefits package with the Infirmary. It provides that an employee must be continuously "disabled" for 180 days (approximately 6 months) before any benefits accrue. Ms. Conway signed an agreement with the Infirmary's insurer ("insurer") on March 27, 2003 under which the insurer agreed to provide her with disability payments subject to a later reduction for any social security disability payments Ms. Conway received.

In April 2003, Ms. Conway received a \$10,525.55 lump sum check from the insurer for six months of disability compensation. She also received a \$1,763.56 check from the insurer for the period of March 2, 2003 through April 1, 2003. Ms. Conway spent approximately \$4,500 of the \$10,525.55 check before she was instructed by counsel that the payment may be an asset of the bankruptcy estate. The remaining amount of the \$10,525.55 check, approximately \$6,000, was placed into her attorney's trust account. The Conways amended their bankruptcy schedules to reflect the disability payments Ms. Conway received from the insurer. They now seek an order from the Court determining the status of this potential asset. The Conways offer various arguments to support their claim that the asset is either not property of the estate or, alternatively, that it is partially exempt property of the estate. The trustee has not objected to the exemptions claimed by the Conways.

LAW

Whether Ms. Conway's disability payments are exempt property of the estate is governed by §§541 and 522 of the Bankruptcy Code. Section 541 determines what is property of the estate upon the commencement of a bankruptcy case. Section 522 allows the debtor to exempt certain property that would ordinarily be included in property of the estate under §541. The

Court will first discuss if the disability payments received by Ms. Conway are property of the estate. Because the Court concludes that they are property of the estate, the Court will discuss if Ms. Conway may partially or fully exempt them.

A.

1.

Section 541(a)(1) provides:

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

11 U.S.C. §541(a)(1).

Section 541(a)(1) of the Code defines property of the estate as all legal or equitable interests of the debtor in property. *Meehan v. Wallace (In re Meehan)*, 102 F.3d 1209, 1210 (11th Cir. 1997). The interest of the debtor does not have to be a complete (100%) interest nor an ownership interest. *See In re Williams*, 197 B.R. 398, 402 (Bankr. M.D. Ga. 1996) (holding that “every conceivable interest of the debtor, future, nonpossessory, contingent, speculative, and derivative, is within the reach of § 541”) (quoting *In re Yonikus*, 996 F.2d 866, 869 (7th Cir. 1993)).

In the amended schedules filed in their bankruptcy case, the Conways list the disability payments Ms. Conway received from the insurer as personal property that may be a potential asset of the estate. However, in their motion for instructions they argue that the payments are not property of the estate because Ms. Conway was not entitled to receive them until March 1, 2003, two days after the Conways filed their bankruptcy case. The Conways explain that, for example, if Ms. Conway had died on February 28, 2003, the day after the Conways filed their

bankruptcy case, Ms. Conway's estate would not be entitled to collect the \$10,525.55 lump sum payment from the insurer.

The Court finds that §541 encompasses Ms. Conway's interest in receiving disability payments from the insurer. Ms. Conway met the definition of "disabled" under the insurance policy prior to the bankruptcy filing. Therefore, she had the right to receive payments under the policy after she was "disabled" for a 180 day period. Ms. Conway exercised this right when she received a \$10,525.55 lump sum payment from the insurer. Moreover, the insurance policy provided that if Ms. Conway had died prior to receiving the lump sum payment, the insurer would have paid her "eligible survivor" a lump sum payment equal to 3 months of her gross disability payment. The interest was at least a contingent one at the time of filing. The Court finds that Ms. Conway's lump sum disability payment and the monthly disability payments she is currently receiving are property of the estate.

2.

Although the Court has found that Ms. Conway's disability payments are property of the estate under §541, she may still exclude her interest in the payments from property of the estate if she meets the requirements of §541(c)(2). Section 541(c)(2) excludes from property of the estate property that has a "restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law." The Court will not consider whether the disability payments are excluded under §541(c)(2) though, because Ms. Conway's counsel conceded (rightfully so under the Court's own analysis) at the hearing that the insurance policy did not contain a transfer restriction enforceable under applicable nonbankruptcy law.

Patterson v. Shumate, 504 U.S. 753 (1992).

B.

1.

Ms. Conway's disability payments may not be excluded from property of the estate of estate under §541(a)(1); however, the Conways may be able to exempt her interest in them under §522(b) of the Bankruptcy Code, which provides:

(b) Notwithstanding section 541 of this title, an individual debtor may exempt from property of the estate the property listed in either paragraph (1) or, in the alternative, paragraph (2) of this subsection. In joint cases filed under section 302 of this title and individual cases filed under section 301 or 303 of this title by or against debtors who are husband and wife, and whose estates are ordered to be jointly administered under Rule 1015(b) of the Federal Rules of Bankruptcy Procedure, one debtor may not elect to exempt property listed in paragraph (1) and the other debtor elect to exempt property listed in paragraph (2) of this subsection. If the parties cannot agree on the alternative to be elected, they shall be deemed to elect paragraph (1), where such election is permitted under the law of the jurisdiction where the case is filed. Such property is--

(1) property that is specified under subsection (d) of this section, unless the State law that is applicable to the debtor under paragraph (2)(A) of this subsection specifically does not so authorize; or, in the alternative,

(2)(A) any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of the filing of the petition, or for a longer portion of such 180-day period than in any other place; and

(B) any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law.

11 U.S.C. §522(b).

“Under 11 U.S.C. §522(b), a debtor may choose between the federal exemptions provided by §522(d) and those provided under state law, unless state law ‘vetoes’ the debtor’s option to choose the federal exemptions.” *In re Wiley*, 184 B.R. 759, 765 (Bankr. N.D. Iowa 1995) (citing to *In re Huebner*, 986 F.2d 122, 1224 (8th Cir. 1993)). Alabama is an “opt-out” state that has “vetoes” its debtors’ option to choose the federal exemptions under §522;

therefore, the only exemptions a debtor may claim under §522(b) in Alabama are the state exemptions. *Dionne v. Harless (In re Harless)*, 187 B.R. 719, 726-27 (Bankr. N.D. Ala. 1995). The Conways cite to Ala. Code sections 6-10-6, 6-10-7, 27-14-31 and to Art. X, Sec. 204 of the Alabama Constitution as the sources of Ms. Conway's exemptions. They claim that these exemptions may be combined to increase the amount of Ms. Conway's total exemption.

The Conways cite *First National Bank of Jasper v. Robinson (In re Robinson)*, 240 B.R. 70 (Bankr. N.D. Ala. 1999), as authority for their argument that they may combine the applicable exemptions provided under Alabama state law.¹ The *Robinson* court candidly admits that the Alabama legislature intended to eliminate this practice, which has been referred to as stacking, by passing "amendments to the Alabama Code designed to prevent stacking." *Robinson* at 91. These "anti-stacking" amendments have been consistently upheld by the Alabama Court of Civil Appeals, *Id.* at 89 (citations omitted), but the Alabama Supreme Court has not considered them yet. *Id.* at 91. Under the doctrine of *stare decisis*, Alabama's lower state courts are bound to follow the decisions of the Alabama Court of Civil Appeals. *Id.* However, the bankruptcy court is a federal court and it is not bound to do so.

Case law holds that "[i]n diversity jurisdiction based cases brought in or to a federal court, it is a rule of general application that a decision rendered by an intermediate state court when the state's highest court has not spoken will be accepted as controlling authority unless there is some persuasive indication that the state's highest court would rule otherwise."

Robinson at 91 (citations omitted). "This rule should be followed in federal courts in the context

¹ The Court appreciates the subtle distinction made by the *Robinson* court differentiating between a procedural limit on the garnishment process and an exemption statute creating a category of exempt property. However, for ease of reference, and because the Alabama state court decisions do not differentiate, the Court will refer to the statutes cited in this opinion as "exemption statutes."

of . . . non-diversity jurisdiction when the exemption being addressed involves state law and no federal law applies . . . to prevent[] inconsistent results by application of identical state laws in different forums” *Id.*

“The jurisdiction of the district courts (from which the bankruptcy court’s jurisdiction is derivative) over bankruptcy matters is established in 28 U.S.C. §1334.”. *Noletto v. NationsBanc Mortgage Corp. (In re Noletto)*, Case No. 98-13813, Adv No. 99-01120 (Bankr. S.D. Ala. February 15, 2000) (citing to *Continental Nat. Bank of Miami v. Sanchez (In re Toledo)*, 170 F.3d 1340, 1344 (11th Cir. 1999)). This Court has non-diversity jurisdiction in this case and its application of Alabama state law exemptions is controlled by the decisions of the Alabama Court of Civil Appeals unless a federal law applies that would change the result. *Robinson* at 91. The Conways have not alleged that a federal law applies in this case that would alter the decisions by the Alabama Court of Civil Appeals.² Therefore, this Court finds that the Conways may not stack the exemptions available to them under Ala. Code sections 6-10-6, 6-10-7, and 27-14-31 with the personal property exemption provided by the Alabama Constitution. The Court is not prepared to adopt the scholarly *Robinson* opinion at this time because of the Alabama courts’ decisions although the Court does agree that the exemption statutes are not a cohesive and consistent group of laws. This Court will follow the Alabama case law.

2.

Although the Conways may not stack Alabama state statutory exemptions with the constitutional personal property exemption, they alternatively argue that the Alabama state statutory exemptions may still be stacked with each other to increase the amount of Ms.

² The *Robinson* court found that the federal garnishment limitation statutes, 15 U.S.C. §1671, *et. seq.*, were applicable to the debtors in that case. This Court does not make any finding that federal statutes are or are not applicable in this case; it simply does not consider their application at this time because the debtors have not alleged that any federal law applies.

Conway's total exemption. The Conways specifically argue that Ms. Conway may stack the exemption provided under Ala. Code §27-14-31 with the exemption provided under Ala. Code §6-10-6. Ala. Code §27-14-31 provides:

The proceeds or avails of all contracts or disability insurance and of provisions providing benefits on account of the insured's disability which are supplemental to life insurance or annuity contracts, heretofore or hereafter effected, shall be exempt from all liability for any debt of the insured and from any debt of the beneficiary existing at the time the proceeds are made available for his use. The exemption of income benefits payable as the result of disability shall not exceed an average of \$250.00 of such benefits per month of the period of disability.

Ala. Code §27-14-31.

The Conways do not cite to any case law interpreting Ala. Code §27-14-31. The Court found no Alabama cases interpreting it. The Court found two cases from other states analyzing statutes with language mirroring that of Ala. Code §27-14-31. See *Mexic v. Mexic*, 634 So.2d 18 (La. Ct. App. 1st Cir. 1994); *Wilmington Trust Co. v. Barry*, 338 A.2d 575 (Del. Super. Ct. 1975). In *Wilmington Trust*, the court broadly construed the exemption statute to include all health insurance contracts, rather than “only such health insurance contracts as are supplemental to life insurance or annuity contracts.” 338 A.2d at 577. It found that an interpretation only exempting contracts that were supplemental to life insurance or annuity contracts would be erroneous and “not supported by any rules of statutory construction” *Id.* The *Mexic* court made a similar finding “[b]ased upon the clear wording of the statutes . . . that a policy of disability insurance is . . . within the meaning of [the exemption statute] and is therefore exempt from seizure.” 634 So.2d at 19.

The Court finds the reasoning of the *Mexic* and *Wilmington Trust* courts persuasive in their statutory construction of a exemption statute very similar to Ala. Code §27-14-31. The Court finds no reason to distinguish between disability insurance contracts “supplement to life

insurance or annuity contracts” and other disability contracts. Therefore, this Court adopts the construction of those courts to determine the meaning of Ala. Code §27-14-31. Based on that construction, the Court finds that the Conways may exempt a portion of Ms. Conway’s disability payments under Ala. Code §27-14-31. The partial exemption may be claimed against Ms. Conway’s lump sum payment and against her monthly payments.

The Conways seek to stack the exemption available to Ms. Conway under Ala. Code §27-14-31 with the exemption available to her under Ala. Code §6-10-6, which provides:

The personal property of such resident, except for wages, salaries, or other compensation, to the extent of the resident's interest therein, to the amount of \$3,000 in value, to be selected by him or her, and, in addition thereto, all necessary and proper wearing apparel for himself or herself and family, all family portraits or pictures and all books used in the family shall also be exempt from levy and sale under execution or other process for the collection of debts. No wages, salaries, or other compensation shall be exempt except as provided in Section 5-19-15 or Section 6-10-7.

Ala. Code §6-10-6. Before the Alabama Legislature amended Ala. Code 6-10-6 in 1988, the Alabama Court of Civil Appeals held that a debtor’s personal property exemption included wages. *Sink v. Advanced Collection Services, Inc.*, 607 So.2d 246, 247 (Ala. Civ. App. 1992) (citing to *Avery v. East Alabama Medical Center*, 514 So.2d 1377 (Ala. Civ. App. 1985)). However, the current version of Ala. Code §6-10-6 specifically excludes “wages, salaries, or other compensation” from inclusion within a debtor’s personal property exemption. *Id.*

The Court finds that the Conways may not stack the exemptions available to Ms. Conway under Ala. Code §27-14-31 with §6-10-6 because Ms. Conway’s disability payments are “wages, salaries, or other compensation” under Ala. Code §6-10-6.

The disability payments are “wages, salaries, or other compensation” for several reasons: 1) her disability payments are part of her compensation package with her employer, 2) federal and state taxes were deducted from her payments, and 3) the amount of her payment is directly

related to the salary she received from her employer. *Id.* at 5-6. Therefore, Alabama Code §6-10-6 excludes Ms. Conway's disability payments from falling within its personal property exemption. The Conways may not exempt any portion of Ms. Conway's payments under Ala. Code §6-10-6.

The remaining state law exemption claimed by the Conways is Ala. Code §6-10-7. It provides in relevant part:

(a) The wages, salaries, or other compensation of laborers or employees, residents of this state, for personal services, shall be exempt from levy under writs of garnishment or other process for the collection of debts contracted or judgments entered in tort in an amount equal to 75 percent of such wages, salaries, or other compensation due or to become due to such laborers or employees, and the levy as to such percentage of their wages, salaries, or other compensation shall be void. The court issuing the writ or levy shall show thereon the amount of the claim of the plaintiff and the court costs in the proceedings. If at any time during the pendency of the proceedings in the court a judgment is entered for a different amount, then the court shall notify the garnishee of the correct amount due by the defendant under the writ or levy. The garnishee shall retain 25 percent of the wages, salaries, or other compensation of the laborer or employee during the period of time as is necessary to accumulate a sum equal to the amount shown as due by the court on the writ or levy. Should the employment of the defendant for any reason be terminated with the garnishee, then the garnishee shall not later than 15 days after the termination of employment, report the termination to the court and pay into court all sums withheld from the defendant's wages, salaries, or other compensation. If the plaintiff in garnishment contests the answer of the garnishee, as now provided by law in such cases, and proves to the court the deficiency or untruth of the garnishee's answer, the court shall enter judgment against the garnishee for such amount as would have been subject to the order of condemnation had the sum not been released to the defendant.

Ala. Code §6-10-7.

To take advantage of the exemption offered under Ala. Code §6-10-7, Ms. Conway's disability payments must be "compensation . . . for personal services." The statute later terms the payments "wages, salaries, or other compensation." The Court concludes that the disability benefits are "compensation . . . for personal services" and "wages, salaries, or other compensation." There are not cases directly on point. However, the court concludes that the

benefits are “other compensation” because the benefit is closely analogous to the benefits that have been held to be covered in the terms “wages, salaries, or other compensation” in case law.

The federal garnishment limitation statute, 15 U.S.C. § 1671 et seq., uses the terms “wages, salaries, and other compensation.” The federal consumer credit garnishment limitation statute has very similar purposes to those of the state garnishment limitations statute. Alabama courts cite to the federal law in interpreting Ala. Code § 6-10-7. *Knight v. Knight*, 658 S.o 2d 478 (Ala. Civ. App. 1994). *Robinson*, supra. at 99. “Earnings” under the federal statute include “periodic payments pursuant to a pension or retirement plan. 15 U.S.C. § 1672(a). Disability payments serve the same purpose and, like retirement or pension payments, are replacement income. The payments are taxed like wages. The payments are an employee benefit like a pension. The Infirmary plan was completely employee funded.

Second, the payments are unlike the ones excluded by case law. *Citronelle-Mobile Gathering, Inc. v. Watkins*, 934 F.2d 1180, 1191 (11th Cir. 1991) suggested that a \$39,750 lump sum “salary” payment was “arguably not for personal services to benefit [the debtors’ employer].” The sum was not a “periodic payment . . . needed to support the wage earner and his family on a week-to-week, month-to-month, basis” (citing *Kokoszka v. Bedford*, 417 U.S. 642, 651, 94 S.Ct. 2431, 2436, 41 L. Ed. 2d 374 (1974)). Ms. Conway’s payments are necessary to the support of her family. The *Citronelle-Gathering* decision expressed doubt as to the true “salary” nature of the payment in that case due to the circumstances of its receipt and its amount. That is not a factor in this case. In *In re Peterson*, 280 B.R. 886, 892 (Bankr. S.D. Ala. 2001) the court held that “the compensation claimed must be that of a ‘laborer’ or ‘employee’” and not an independent contractor. In the *In re Dean* case, 91 B.R. 125 (Bankr. N.D. Ala. 1988),

independent contractors' commissions have been held to be excluded. Ms. Conway was a full time employee. She was not an independent contractor.

Ms. Conway's benefits are to be paid to her pursuant to the Infirmity's long term disability plan. The Infirmity paid all costs of the plan. No employee contributions were required. The plan states that "[t]he long term disability plan provides financial protection for you by paying a portion of your income while you are disabled. The amount you receive is based upon the amount earned before your disability began. In some cases, you receive disability payments even if you work while you are disabled." (*Infirmity Health Systems, Inc. Plan* at p.3, *Exhibit 1*). The plan, as this language and the employer funding make clear, is an income replacement vehicle for Infirmity employees. As a benefit of employment, this Court concludes it is "other compensation" to employees paid to them as a part of their earnings for personal services performed in the past. Therefore, section 6-10-7 is available to the Conways. However, since the payments are wages, the Conways cannot use section 6-10-6 in conjunction with section 6-10-7 in a stacking manner.

Finally, the Court must consider whether the Conway's may stack the exemptions available to Ms. Conway under Ala. Code §27-14-31 with §6-10-7 or any applicable federal statute. Stacking the exemptions provided in these two statutes would exempt 75% of Ms. Conway's net disability payments under Ala. Code §6-10-7 plus an additional \$250 per month under Ala. Code §27-14-31. This would give the Conways an \$8,144.16 exemption for Ms. Conway's lump sum disability payment (75% of the \$10,525.55 lump sum payment, which represented 6 months salary, plus \$250 per month multiplied by 6 months) and a \$1,572.67 exemption for her monthly net disability payments (75% of the \$1,322.67 net monthly disability payment plus \$250).

The Court finds that the Conways may stack the exemptions available to Ms. Conway. Unlike the Court's analysis of the anti-stacking amendments to Ala. Code §6-10-6 and Art. X, Sec. 204 of the Alabama Constitution, the Court could not locate any authority indicating that the exemptions provided by Ala. Code §27-14-31 and 6-10-7 may not be stacked. However, because the amount that the Conways may exempt each month by stacking these two statutes is greater than \$1,000, the Court must consider the effect of Ala. Code §6-10-37.

Ala. Code §6-10-37 states in relevant part:

No claim for exemptions shall exceed the greater of the amounts authorized by the Constitution of 1901, as amended, or required by provisions of federal law.

Ala. Code §6-10-37. The language of Ala. Code §6-10-37 appears to limit the total amount of a debtor's exemptions to either \$1,000 or a larger amount as required by federal law. However, the Alabama Court of Civil Appeals has found that Ala. Code §6-10-37's apparent \$1,000 limit on exemptions merely "provide[s] a minimum exception below which the legislature may not go." *Sink v. Advanced Collection Services, Inc.*, 607 So.2d 246, 248 (Ala. Civ. App. 1992) (citing *Miller v. Marx*, 55 Ala. 322 (1876)). Therefore, this Court finds that Ala. Code §6-10-37 does not limit the Conways stacked exemptions under Ala. Code §§27-14-31 and 6-10-7 because the \$1,000 exemption "limit" provided by Ala. Code §6-10-37 is the minimum rather than maximum exemption that a debtor may claim under Alabama's state exemption laws. *Sink* at 248.

CONCLUSION

The motion for instructions filed by Anthony and Susan Conway is GRANTED to the extent of the above guidance provided by the Court. The Conways may exempt \$8,144.16 of Ms. Conway's lump sum disability payment and \$1,572.67 of each of her monthly payments if

they utilize both Ala. Code sections 6-10-7 and 27-14-31. The Conways must AMEND their schedules to comply with this order.

Dated: September 9, 2003


MARGARET A. MAHONEY
U.S. BANKRUPTCY JUDGE