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DISORDERLY AND DISCRIMINATORY: THE BANKRUPTCY CODE'S TREATMENT OF DISABLED DEBTORS

ABSTRACT

Disability benefits in bankruptcy face uncertainty under the current exemption system. The enumerated federal exemptions are poorly drafted, lack useful legislative history, and classify benefits depending on the benefit's source. The opt out provision found in section 522(b) of the Bankruptcy Code allows jurisdictions to limit debtors to the state's exemptions rather than the federal exemptions. Depending on which exemption the court places the disability benefits under, the benefits may be fully exempt from the bankruptcy estate, limited to the amount reasonably necessary for the debtor's support, or unexempt. The bankruptcy courts struggle to uniformly apply the federal and state exemptions, resulting in three main issues. First is the classification of the disability benefits, which determines if the benefit will be fully exempt, unexempt, or partially exempt. Second is the poorly drafted federal exemptions create temporal issues for disability benefits, including past benefits and the right to future benefits. Third is the courts' struggle with the form of the disability benefits, especially if the benefit is not cash, and struggle to decide whether the exemptions also cover funds deposited and goods purchased with the funds.

This Comment proposes several amendments to the Code to combat the three main issues for disability benefits: first, defining the term disability benefit in section 101 of the Code; second, redrafting the exemptions in section 522; and third, eliminating the opt out provision solely for disability benefits in section 522(b). Finally, the proposed system is directly compared with the current exemption system, demonstrating the proposed system's equity and ease of application.

INTRODUCTION

Imagine an ordinary man named Joe. Joe worked a blue-collar job for years and was injured at the workplace. Although Joe received disability payments through his job, he was unable to return to work due to his injuries. Joe began to fall behind on his mortgage. Joe accumulated credit card debt paying for basic necessities. Faced with hounding creditors, Joe turned to bankruptcy and filed a chapter 7 case. Joe soon finds out his only source of income—the disability payments he received from his employer—are being reduced by the court to pay off creditors. As Joe is waiting outside the courthouse, he bumps into an old friend, Bob. Bob has also filed for bankruptcy following a workplace injury. Bob was awarded Social Security Disability Income (SSDI). Bob tells Joe that his SSDI is not available to his creditors. In disbelief, Joe calls up his friend Suzy from a few states over and finds out she is in the exact same situation; however, she gets to keep all of her private disability payments. This unfair situation occurred because the Bankruptcy Code allows for the inequitable treatment of disabled individual debtors depending on where the debtor resides and the form of disability received.

The Code discriminates against disabled debtors in several ways. First, the Code allows for states to “opt out” of the enumerated federal bankruptcy exemptions, which results in different results in different jurisdictions. Second, the Code and various state laws classify disability payments differently depending on their source. For example, social security, a private disability policy, a worker’s compensation award, and personal bodily injury are all classified differently. This classification determines whether the payments are exempt in full, partially exempt, or not exempt at all.

This Comment will explore the harsh realities that disabled debtors face as courts struggle to apply the exemptions in section 522(d) and applicable state law to determine whether the debtor’s disability payments are entirely exempt, partially exempt, or nonexempt.¹ This Comment will first demonstrate the conflicting applications of the current exemption system. Next, this Comment will propose several amendments to rectify the issues. Finally, this Comment will demonstrate the equity of the proposed system by directly comparing it to the current exemption system.

Section 522(d) lists the exemptions from the bankruptcy estate for individual debtors.² This Comment will discuss the following exemptions in detail: section

¹ 11 U.S.C. § 522(d) (2019).

² *Id.*

522(d)(10)(A) (the “SSDI Exemption”), which exempts from creditors the debtor’s right to receive a social security benefit;³ section 522(d)(10)(C) (the “Disability Exemption”), which exempts from creditors the debtor’s right to receive “a disability, illness, or unemployment benefit;”⁴ section 522(d)(10)(E) (the “Contract Exemption”), which exempts from creditors the debtor’s right to receive “payment under a stock bonus, pension, profit sharing, annuity or similar plan or contract on account of illness, disability” to the extent reasonably necessary for the support of the debtor;⁵ section 522(d)(11)(D) (the “Personal Injury Exemption”), which exempts from creditors payment, “not to exceed \$25,150, on account of personal bodily injury;”⁶ and section 522(d)(11)(E) (the “Future Earnings Exemption”), which exempts from creditors the debtor’s right to receive, or property that is traceable to, “a payment in compensation of loss of future earning of the debtor . . . to the extent reasonably necessary for support of the debtor”⁷ While these separate Code provisions seem simple, each may cover a disability benefit or payment depending on how the debtor receives the payments. As one court notes “parsing exemption claims concerning lost income disability payments is like hacking one’s way through a thicket.”⁸

The confusion does not end with the enumerated federal bankruptcy exemptions. Section 522(b) allows for the debtor to choose between the exemptions enumerated in section 522(d) and the exemptions under state law.⁹ If a state chooses, it may expressly limit debtors to the exemptions available under state law. This option, notoriously called the “opt-out” provision, has been a source of controversy since the Bankruptcy Reform Act of 1978.¹⁰ Thirty-five states have “opted out” under section 522(b) and only allow debtors to use state law exemptions.¹¹ The remaining fifteen states and the District of Columbia allow debtors to choose between the federal exemptions and state law exemptions.¹²

³ *Id.* § 522(d)(10)(A).

⁴ *Id.* § 522(d)(10)(C).

⁵ *Id.* § 522(d)(10)(E).

⁶ *Id.* § 522(d)(11)(D).

⁷ *Id.* § 522(d)(11)(E).

⁸ *In re de Kleinman*, 172 B.R. 764, 776 (Bankr. S.D.N.Y. 1994).

⁹ See 11 U.S.C. § 522(b) (“If the effect of the domiciliary requirement under subparagraph (A) is to render the debtor ineligible for any exemption, the debtor may elect to exempt property that is specified under subsection (d)”).

¹⁰ The Honorable William Houston Brown, *Political and Ethical Considerations of Exemption Limitations: The “Opt-Out” as Child of the First and Parent of the Second*, 71 AM. BANKR. L.J. 149, 159 (1997).

¹¹ See 4 COLLIER ON BANKRUPTCY § 522.02[1] & n. 3 (Lawrence P. King ed., 15th ed. 1996).

¹² See *id.*

I. BACKGROUND

This Section will explore the origins and purposes of exemptions, the history of the federal exemption opt-out scheme, and the dated judicial basis for the lack of personal uniformity in the bankruptcy courts, which injures and discriminates against disabled debtors. Since the beginning of bankruptcy law, debtors have been able to exempt a portion of their property from the bankruptcy estate and the reach of creditors.¹³ The “purpose of an exemption is to protect a debtor and his family against absolute want,”¹⁴ preserving the fresh start.¹⁵ Although only mentioned once in the Code, the fresh start strives to separate debtors from their pre-bankruptcy life and allow them to successfully reenter the economic sphere.¹⁶ Exemptions from the bankruptcy estate serve “to facilitate a debtor’s ‘fresh start’ by allowing retention of sufficient resources to sustain basic needs; creditors are entitled to the balance, if any.”¹⁷ Exemptions are only available to individual debtors.¹⁸

When the Commission on the Bankruptcy Laws of the United States was created, it criticized allowing states to use their own exemptions, calling the system “intolerable for what is supposed to be a national, uniform system and destructive to the goal of rehabilitation of individual debtors.”¹⁹ The Commission advised eliminating the state exemption scheme in favor of a single federal list of exemptions.²⁰ The Senate’s bill reflected the Commission’s recommendations and did not offer an opt-out for states, but the House version did.²¹ Ultimately, a compromise was reached and the House version was adopted with the lower exemption dollar amounts the Senate bill contained.²²

The Constitution grants Congress the exclusive authority to establish “uniform Laws on the subject of Bankruptcies throughout the United States.”²³

¹³ See Louis Edward Levinthal, *The Early History of Bankruptcy Law*, 66 U. PA. L. REV. 223, 237–38 (1918).

¹⁴ *Medill v. State*, 477 N.W.2d 703, 708 (Minn. 1991).

¹⁵ See generally Jonathon S. Byington, *The Fresh Start Canon*, 69 FLA. L. REV. 115, 115 (2017) (“A primary policy of bankruptcy law is to give consumer debtors a ‘fresh start’ by discharging their debt”).

¹⁶ See generally *id.* at 116 (noting that bankruptcy provides “a debtor ‘a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt.’”) (citing *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934)).

¹⁷ *In re Wegrzyn*, 291 B.R. 2, 9 (Bankr. D. Mass. 2003).

¹⁸ 11 U.S.C. § 522(b)(1) (2019).

¹⁹ H.R. REP. NO. 95-595, at 169 (1973). Congress established a Commission on Bankruptcy Laws to consider amending the disability structure in the Code. *Id.*

²⁰ *Id.*

²¹ See S. 2266, 95th Cong. § 522 (1978); H.R. 8200, 95th Cong. § 522 (1978).

²² H.R. 8200, 95th Cong. § 522 (1978) (enacted).

²³ U.S. CONST. art. I, § 8, cl. 4.

While this clause seems straightforward, “[a]ny such simplistic reading of the Bankruptcy Clause has not proven correct, especially in the area of exemptions.”²⁴ Interpreting the Bankruptcy Act of 1898, the Supreme Court held in *Hanover National Bank* that the Bankruptcy Clause does not require personal uniformity, only geographical uniformity.²⁵ *Hanover National Bank* allows states to draft their own exemptions without violating the Bankruptcy Clause. However, the Supreme Court has yet to interpret the current Code to determine whether *Hanover National Bank* is still good law.

There are numerous definitions of disability. For example, the U.S. Census defines disability to include deafness, blindness, inability to perform one or more of the functional activities, use of wheelchair, needing assistance of another to perform daily functions, having difficulty finding and obtaining a job, Alzheimer’s, developmental delay, intellectual disability, and frequent mental health problems.²⁶ As of June 2020, disabled individuals account for 12.9% of the beneficiaries of Social Security.²⁷ As of December 2018, approximately 10 million disabled workers, spouses of disabled workers, and children of disabled workers received an average of \$1,096.99 monthly in benefits.²⁸ While no clear statistics exist for the number of disabled individuals filing for bankruptcy, in 2010 approximately one in five Americans lived with a disability²⁹ and approximately one in ten Americans have a severe disability.³⁰ Bankruptcy filings vary by state, from 0.55 of out 1,000 residents to 5.4 out of 1,000 residents.³¹ While these statistics may suggest that there are not many disabled individuals that go through bankruptcy, those that do file for bankruptcy relief have an extremely difficult time—especially considering that the debtor is unsure how the court will treat his disability payments that may be his sole source of income.

²⁴ Brown, *supra* note 10, at 171.

²⁵ See *Hanover Nat’l Bank v. Moyses*, 186 U.S. 181, 188–89 (1902).

²⁶ See *id.* at 1–3.

²⁷ SOCIAL SECURITY ADMINISTRATION: DISABILITY BENEFICIARIES, <https://www.ssa.gov/OACT/ProgData/icp.html> (last visited Jan. 10, 2021).

²⁸ *December 2018 Disability Statistics*, SOCIAL SECURITY ADMINISTRATION, <https://www.ssa.gov/OACT/ProgData/icp.html> (type December in the month field and 2018 in the year field; then click GO) (last visited Jan. 10, 2021).

²⁹ MATTHEW W. BRAULT, U.S. CENSUS BUREAU, AMERICANS WITH DISABILITIES: 2010 HOUSEHOLD ECONOMIC STUDIES 4 (2012).

³⁰ See *id.* at 1–3.

³¹ Lyle Daly, *Personal Bankruptcy Statistics for 2020*, THE ASCENT (Mar. 24, 2020), <https://www.fool.com/the-ascent/research/personal-bankruptcy-statistics/>.

II. PROOF OF CLAIM

This Section will explore the three main issues that arise for all disability benefits. The first Subsection covers courts' confusion on where to place different versions of disability benefits under section 522 despite the enumerated federal exemptions and state law exemptions. The second Subsection will cover temporal issues with all versions of disability benefits and detail some state law exemption issues. The third and final Subsection will cover issues based on the form of the disability payment. Disability benefits come in many forms outside of cash payments, adding confusion for courts. Ultimately, this Section will demonstrate that disabled debtors are unfairly discriminated against based on their form of disability benefit and jurisdiction.

A. *First Issue: Classification of the Disability Benefit*

The main problem disabled debtors face is classification of their benefits. Because classification will determine if the benefits are exempt in full, partially exempt, or unexempt, it is an extremely important issue. Courts generally cannot decide which disability benefit should be placed under which exemption because the "four subsections share a common theme: each enumerated benefit or right to payment is based upon a condition of the recipient typically associated with immediate need."³²

1. *Social Security Disability Benefits*

Social Security payments, including SSDI, are exempt from the bankruptcy estate under the SSDI Exemption.³³ The exemption includes the right to receive a social security benefit as a stream of future income. This exemption is also contained within the Social Security Law itself.³⁴

³² *In re Dale*, 252 B.R. 430, 435 (Bankr. W.D. Mich. 2000).

³³ Note that all exemptions have been previously defined and cited to the Code. *See infra* page 399.

³⁴ The Social Security Act reads:

The right of any person to any future payment under this title shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this title shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law.

42 U.S.C.A. § 407(a) (West).

2. Private Disability Benefits

Although “there is and should be no distinction between disability benefits which are publicly provided and those which arise through private contracts,”³⁵ private disability benefits appear to be the subject of two different exemptions. Private disability benefits can fall under the Disability Exemption, which fully exempts a debtor’s right to receive “a disability, illness, or unemployment benefit,”³⁶ or the Contract Exemption which exempts “payment under . . . a pension . . . annuity . . . or contract on account of illness, disability.”³⁷ Benefits under the Disability Exemption are fully exempt while benefits under the Contract Exemption are only exempt to the amount reasonably necessary for the debtor’s support. While the “use of the term disability benefit in (s)ection 522(d)(10)(C) . . . may also encompass payment under a privately purchased disability policy,”³⁸ courts generally place this type of award under the Contract Exemption instead, making the benefit less likely to be exempt.³⁹

The court in *Wegrzyn* acknowledged “struggle in articulating a meaningful and consistent method of differentiating between benefits falling under (s)ection 522(d)(10)(C) from those falling under (s)ection 522(d)(10)(E).”⁴⁰ Yet, another court noted that “Congress must have intended a distinction between them.”⁴¹ As one court noted “payments under privately purchased disability insurance policies do not fit neatly within” the exemption.⁴² because “[b]oth subsections (C) and (E) compensate for disability benefits.”⁴³

The legislative history of section 522(d)(10) does little to remedy the confusion. The legislative history is as follows:

Paragraph (10) exempts certain benefits that are akin to future earnings of the debtor. These include social security, unemployment compensation, or public assistance benefits, veteran’s benefits, disability, illness, or unemployment benefits, alimony, support, or separate maintenance (but only to the extent reasonably necessary for the support of the debtor and any dependents of the debtor), and benefits under a certain stock bonus, pension, profit sharing, annuity

³⁵ *In re Bowen*, 458 B.R. 918, 923 (Bankr. C.D. III. 2011).

³⁶ 11 U.S.C. § 522(d)(10)(C) (2019).

³⁷ *Id.* § 522(d)(10)(E).

³⁸ *Sheehan v. Lincoln Nat. Life*, 257 B.R. 449, 455 (N.D. W. Va. 2001); *see also In re Morehead*, 283 F.3d 199, 205 (4th Cir. 2002).

³⁹ *See In re Wegrzyn*, 291 B.R. 2, 9 (Bankr. D. Mass. 2003).

⁴⁰ *Id.* at 6.

⁴¹ *In re Evans*, 29 B.R. 336, 337 (Bankr. D.N.J. 1983).

⁴² *In re Morehead*, 283 F.3d at 205.

⁴³ *In re Evans*, 29 B.R. at 337.

or similar plan based on illness, disability, death, age or length of service.⁴⁴

The legislative history fails to distinguish between benefits and payments or what is fully exempt under each subsection. The legislative history “do[es] not provide a consistently workable test for identifying benefits qualifying for full or partial exemption.”⁴⁵ Further, the distinctions between “public versus private benefits do not satisfactorily inform the debate.”⁴⁶

Since the legislative history offers little enlightenment, courts must decide for themselves where to place a private disability policy. Although not explicitly said, courts may utilize the Contract Exemption over the Disability Exemption because private disability policies generally arise out of contract, whether the policy is provided through the debtor’s work or privately purchased. This interpretation, however, would render the Disability Exemption superfluous. Another possible motivation is to offer creditors some chance of repayment. For example, if a debtor’s sole source of income is a private disability policy and the debtor can exempt a large portion of the estate using other exemptions available, unsecured creditors may be left with almost nothing. This could lead to creditors being less likely to loan money to disabled individuals or charge higher interest rates.

When a court does place a private disability policy under the Contract Exemption, it must limit it to an amount “reasonably necessary for the support of the debtor.”⁴⁷ However, disability expenses may vary wildly from month to month depending on the debtor’s current health, unexpected expenses, necessary treatments, and therapy. In addition, courts look to the age of the debtor in deciding whether to even allow an exemption. “The young debtor has been denied an exemption” because they have more time to earn money.⁴⁸ While for “the elderly debtor, where no future earning capacity exists, the exemption is allowed.”⁴⁹

State law issues involving exemptions may arise as well. For example, New Hampshire law fully exempts periodic payments, including disability payments, from bankruptcy proceedings.⁵⁰ When a debtor attempted to exempt her

⁴⁴ H.R. REP. NO. 95-595, at 362 (1977).

⁴⁵ *In re Wegrzyn*, 291 B.R. at 7.

⁴⁶ *Id.*

⁴⁷ 11 U.S.C. § 522(d)(10)(E) (2019).

⁴⁸ *In re Bari*, 43 B.R. 253, 256 (Bankr. D. Minn. 1984).

⁴⁹ *Id.*

⁵⁰ See N.H. Rev. Stat. Ann. § 167:25 (“All assistance given hereunder shall be inalienable by any

payments using the state exemption, the court analogized instead to the federal exemptions.⁵¹ The court held that under federal law, the disability payment would be classified under the Contract Exemption, not the Disability Exemption. Therefore, the debtor's payments had to be limited, even under New Hampshire law.⁵² Under North Carolina law, an opt-out state, "[t]he court or judge may order any property . . . to be applied towards the satisfaction of the judgment"⁵³ but creates an exemption for "the earnings of the debtor for his personal services . . . when it appears by the debtor's affidavit or otherwise, that these earnings are necessary for the use of a family supported wholly or partly by his labor."⁵⁴ In one case, a debtor in North Carolina received \$2,262.00 a month from a private disability insurance after injury.⁵⁵ The court concluded that the debtor could not exempt the disability insurance payments at issue because they "result[ed] from a contractual right to payment based on the happening of a fortuitous event"⁵⁶ and "are paid as a result of nonperformance rather than performance . . ."⁵⁷ The payments were not considered earnings necessary for the debtor's and his family's support.

In conclusion, debtors with private disability policies face uncertainty in bankruptcy. Disabled debtors can be discriminated against due to a lack of clear legislative history, varied placement under the Disability Exemption or the Contract Exemption, and state law issues adding to the confusion.

3. *Worker's Compensation*

Debtors receiving worker's compensation as a substitute for wages face similar issues as debtors with private disability policies. "As is the case with privately funded disability payment plans, exemption of worker's compensation benefits appears the subject of more than one subsection."⁵⁸ Courts generally place the award under the Disability Exemption.⁵⁹ However, a minority of

assignment or transfer and shall be exempt from levy or execution under laws of this state including periodic payments on any judgment of any kind").

⁵¹ *In re Valentine*, No. 08-12074-JMD, 2009 Bankr. LEXIS 3192, at *10-11, *21, *23 (Bankr. D.N.H. Oct. 14, 2009).

⁵² *Id.* at *12.

⁵³ N.C. Gen. Stat. Ann. § 1-362.

⁵⁴ *Id.*

⁵⁵ *See In re Dillon*, No. 05-10428C-7D, 2005 Bankr. LEXIS 1314, at *1 (Bankr. M.D.N.C. July 8, 2005).

⁵⁶ *Id.* at *3.

⁵⁷ *Id.* at *4.

⁵⁸ *In re Wegrzyn*, 291 B.R. 2, 7 (Bankr. D. Mass. 2003).

⁵⁹ *See, e.g., In re Cain*, 91 B.R. 182, 183 (Bankr. N.D. Ga. 1988) ("three different subsections of the exemptions could arguably be applied to Workers' Compensation benefits"); *In re Holstine*, No. 11-14573, 2012 U.S. Dist. LEXIS 97323, at *4 (E.D. Mich. July 15, 2012) ("Holstine's award falls within the text of both

jurisdictions place worker's compensation under the Future Earnings Exemption which exempts, but limits, a debtor's right to receive a payment in compensation of loss of future earnings of the debtor.⁶⁰

Due to the equitable nature of worker's compensation awards, the payments are usually placed under the Disability Exemption over the Future Earnings Exemption so that the awards can be fully exempt. Similar to private disability benefits, courts use the legislative history of section 522 when deciding where to place the award. One court articulated the distinction between the legislative history of section 522(d)(10), which focuses on benefits that are akin to future earnings of the debtor and compared it to the legislative history of section 522(d)(11), which focuses on compensation for losses.⁶¹ Section 522(d)(10) exempts certain benefits that are "*akin to future earnings of the debtor*" while section 522(d)(11) "*allows the debtor to exempt certain compensation for losses.*"⁶²

Another court, expanding on the legislative history reasoned that "paragraphs (11)(D) & (E) deal with recoveries for losses, which in some instances, could be hundreds of thousands of dollars and greatly exceed an amount reasonably necessary for the support of the debtor"⁶³ Workers' compensation covers medical bills and compensates the employee according to the employee's weekly pay but does not include punitive or pain and suffering damages like tort awards may, therefore it is usually already set at an amount reasonably necessary for support.⁶⁴ Workers' compensation benefits are designed "only to prevent the individual from becoming destitute."⁶⁵ Since workers' compensation covers the debtor's inability to continue working at their previously employed levels and are based on the debtor's original wage, they are more similar to "future earnings of the debtor."⁶⁶ Workers' compensation aims to help injured employees "whose ability to generate future earnings has been reduced, or as in this case, completely lost because of a work related injury."⁶⁷

§ 522(d)(10)(C) and § 522(d)(11)(E). It can be readily characterized as either 'property that is traceable to . . . payment in compensation of loss of [Holstine's] future earnings' or as 'a disability, illness or unemployment benefit.'").

⁶⁰ See *supra* page 399.

⁶¹ See *In re Evans*, 29 B.R. 336, 337 (Bankr. D.N.J. 1983).

⁶² *Id.* (emphasis in original).

⁶³ *In re LaBelle*, 18 B.R. 169, 170 (Bankr. D. Me. 1982).

⁶⁴ See *In re Thomas*, No. 4-89-6305, 1990 Bankr. LEXIS 1020, at *6-7 (Bankr. D. Minn. May 11, 1990).

⁶⁵ *In re Evans*, 29 B.R. at 338.

⁶⁶ *In re LaBelle*, 18 B.R. at 171.

⁶⁷ *Id.*

This legislative history and equitable interpretation extends to state law exemptions. Interpreting New York law identical to the Disability Exemption, a court ruled a worker's compensation award was exempt as a disability benefit rather than as a compensation award.⁶⁸ The court reasoned that the absence of New York legislative history points to disability benefits encompassing workers' compensation awards even though a debtor may end up receiving a head start.⁶⁹ The court explained that a head start is possible if an individual with a pending workers' compensation claim files for bankruptcy, receives a discharge of any prepetition living expenses, and then receives a post-discharge reward that covers prepetition expenses.⁷⁰ This timing allows the "indebtedness to be discharged while permitting the debtor to retain the prepetition benefits"⁷¹

Courts generally view the Disability Exemption and the Future Earnings Exemption as mutually exclusive.⁷² A court has noted that Congress cannot have intended for workers' compensation awards to fit under both the Disability Exemption, which is an unlimited exemption, and the Future Earnings exemption, which must be reduced to the amount reasonably necessary for the support of the debtor.⁷³ One court's early interpretation of workers' compensation exemptions disagreed with this logic, splitting the award and fitting it under both the Disability Exemption and the Future Earnings exemption.⁷⁴ This court placed the portion of the award that represented the debtor's accrued disability while waiting for the case to settle as exempt under the Disability Exemption and placed the remainder of the award under the Future Earnings Exemption, since it represented a right to receive compensation for loss of future earnings.⁷⁵ Although very few courts have agreed with this line of

⁶⁸ See *In re Herald*, 294 B.R. 440, 447 (Bankr. W.D.N.Y. 2003) ("Section 282.2.(c) of the DCL that is identical to the exemption provision set forth in Section 522(d)(10)"; see N.Y. Debt. & Cred. Law § 282 (McKinney).

⁶⁹ *In re Herald*, 294 B.R. at 447–48.

⁷⁰ *Id.*

⁷¹ *Id.* at 447 (punctuation omitted).

⁷² See generally *In re Nielsen*, 401 B.R. 149 (Bankr. M.D. Pa. 2009) (workers' compensation award exempt under Disability Exemption only); *In re Cain*, 91 B.R. 182 (Bankr. N.D. Ga. 1988) (same); *In re Herald*, 294 B.R. at 440 (workers' compensation award exempt under New York equivalent of Disability Exemption); *In re Thomas*, No. 4-89-6305, 1990 WL 62438, at *2 (Bankr. D. Minn. May 11, 1990) (lump sum workers' compensation award exempt under the Future Earnings Exemption only); *In re Sanchez*, 362 B.R. 342 (Bankr. W.D. Mich. 2007) (same).

⁷³ See *In re McClure*, 175 B.R. 21, 22 (Bankr. N.D. Ill. 1994) (applying Illinois exemptions and discussing federal exemptions).

⁷⁴ *In re Lambert*, 9 B.R. 799, 800–01 (Bankr. W.D. Mich. 1981) ("[n]o cases have been decided under the above exemption provisions").

⁷⁵ *Id.* at 800.

reasoning, one court stated there is “no indication that [debtors] are restricted to alternatives when a debtor receives two different payments for a single injury.”⁷⁶

A workers’ compensation reward can be denied any exemption. In a noteworthy case, the court refused to exempt a workers’ compensation lump sum award of \$42,000 that had been segregated and set aside one year prior to the bankruptcy filing.⁷⁷ The court reasoned that the award did not fall within the Future Earnings Exemption because that exemption only covers “compensation received in the nature of tort liability.”⁷⁸ While the court noted that there was influential precedent to place the award under the Disability Exemption, the fact that the award was already distributed meant that it did not fall within the language of the exemption excluding a “debtor’s right to receive.”⁷⁹ The court was especially critical of the language in the Disability Exemption that lacks language similar to “property that is traceable” found in the Future Earnings Exemption.⁸⁰ The court noted the Disability Exemption “does not go the extra step and exempt property that is traceable from the original workmen’s compensation award,”⁸¹ so the award in the case at hand could not be classified under the Disability Exemption. The court reasoned that “a right to claim an exemption is a statutory right and is not derived from equitable considerations”⁸² because if an “exemption is not allowed by statute, it not allowable.”⁸³

A workers’ compensation award can be denied any exemption under the Disability Exemption, the Future Earnings Exemption, and the New York state law equivalent if the award has been partially spent and comingled with other funds.⁸⁴ The court reasoned that the New York law, like the Disability Exemption, does not include property that is traceable to the award.⁸⁵ The court noted that the New York legislature “limited the exemption provided for under (s)ections 5205(1) and (1)(2), to Workers’ Compensation funds received by direct or electronic deposit within forty-five days of filing. . . .”⁸⁶

⁷⁶ *In re Bishop*, No. 95-82479, 1996 WL 33401350, at *2 (Bankr. C.D. Ill. Feb. 26, 1996).

⁷⁷ *See In re Michael*, 262 B.R. 296, 297 (Bankr. M.D. Pa. 2001).

⁷⁸ *Id.*

⁷⁹ *See id.* at 298. In effect, because the award had already been paid out as tort damages, it was not a future earning. *Id.*

⁸⁰ *Id.* (comparing 11 U.S.C. § 522(d)(C)(10) (2019) with *id.* § 522(d)(11)(E)).

⁸¹ *In re Michael*, 262 B.R. at 299.

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *In re Wydner*, 454 B.R. 565, 568 (Bankr. W.D.N.Y. 2011).

⁸⁵ *Id.* at 573.

⁸⁶ *Id.*

In conclusion, debtors receiving a worker's compensation award face uncertainty in bankruptcy. Depending on the court and the circumstances, the award may be placed under the Disability Exemption or the Future Earnings Exemption, both exemptions, or neither exemption.

4. *Personal Injury*

Like private disability policies and workers' compensation, personal injury awards may fall under two different exemptions. The statute calls for courts to place personal injury awards under the Personal Injury Exemption which exempts the debtor's payment, "not to exceed \$25,150, on account of personal bodily injury" or under the Future Earnings Exemption as payment in compensation of loss of future earnings.⁸⁷ Personal injury is different from private disability and worker's compensation because it does not serve to directly benefit a disabled worker but rather "to make the injured person whole by serving as the monetary equivalent of the harm suffered"⁸⁸ and make the "injured debtor whole in the eyes of the law."⁸⁹ The exemption covers a tort remedy, rather than a right arising from contract like workers' compensation or private disability benefits.⁹⁰

Courts usually place personal injury awards under the Personal Injury Exemption because it is the most straightforward interpretation of the Code.⁹¹ Under the Personal Injury Exemption, the award must be reduced. Due to the nature of a tort award, a court may look to the different damages the debtor received.⁹² General damages usually cover "temporary or permanent physical and mental loss or impairment, including lost future earning capacity; pain and suffering, including that reasonably certain to occur in the future; and future suffering, including that reasonably certain to occur in the future; and future medical costs reasonably certain to occur."⁹³ Special damages instead cover quantifiable losses, which are usually expenses that are discharged in

⁸⁷ 11 U.S.C. 522(b)(11)(D); *see generally In re Chavis*, 207 B.R. 845 (Bankr. W.D. Pa. 1997) (award placed under Personal Injury Exemption).

⁸⁸ *In re Bailey*, 84 B.R. 608, 610 (Bankr. D. Minn. 1988).

⁸⁹ *In re Butcher*, 189 B.R. 357, 365 (Bankr. D. Md. 1995), *aff'd*, 125 F.3d 238 (4th Cir. 1997).

⁹⁰ *See In re Chesley*, 526 B.R. 888, 894 (M.D. Fla. 2014).

⁹¹ *See In re Buchholz*, 144 B.R. 443, 445 (Bankr. N.D. Iowa 1992); *In re Chavis*, 207 B.R. at 849; *In re Chesley*, 526 B.R. at 895; *In re Haynes*, 146 B.R. 779, 781 (Bankr. S.D. Ill. 1992); *Kollar v. Miller*, 176 F.3d 175, 182 (3d Cir. 1999); *Mercer v. Monzack*, 170 B.R. 759, 763 (D.R.I. 1994), *aff'd*, 53 F.3d 1 (1st Cir. 1995).

⁹² *But see In re Mercer*, 158 B.R. 886, 889 (Bankr. D.R.I. 1993) (court considers debtor's testimony and letter from treating physician on debtor's disability when the debtor's \$50,000 award was not broken down by damages).

⁹³ *In re Bailey*, 84 B.R. at 610.

bankruptcy.⁹⁴ Because of this distinction, the portion of the award that represents general damages should not be limited, but the portion of the award that represents special damages should be limited to avoid giving debtors a head start rather than a fresh start.⁹⁵

Although the personal injury awards must be reduced, courts recognize that “personal injury. . . deals . . . with human capital” and that bankruptcy should protect it because a “debtor who suffers serious personal injury is deprived of using his or her human capital in getting a fresh start.”⁹⁶ Courts have considered “age, present employment, future employment prospects, and general health” of the debtor when limiting the award to a reasonably necessary amount.⁹⁷ Additionally, courts must limit the award to account for the debtor’s basic needs but “not to maintain the debtor’s present lifestyle.”⁹⁸ This balance protects both debtors and creditors by protecting the fresh start, but also preventing debtors from exempting massive awards when discharging prepetition debt.⁹⁹

A court may also split the personal injury award into two different components, classifying the punitive piece under the Personal Injury Exemption and the remaining under the Future Earnings Exemption.¹⁰⁰ The court reduces the punitive piece of the award, or the special damages but allows the portion of the award to compensate for lost wages to be exempt.¹⁰¹ A unique situation that arises in personal injury is the possibility of multiple awards. If the debtor suffers separate injuries and receives multiple awards, whether the debtor is limited to exempting a single award or multiple awards is a source of conflict within the courts.¹⁰²

⁹⁴ See *Medill v. State*, 477 N.W.2d 703, 706 (Minn. 1991).

⁹⁵ See *In re Bova*, 205 B.R. 467, 477 (Bankr. E.D. Pa. 1997).

⁹⁶ *Medill*, 477 N.W.2d at 708.

⁹⁷ *In re Greenly*, 481 B.R. 299, 316 (Bankr. E.D. Pa. 2012).

⁹⁸ *Id.*

⁹⁹ See *In re Rauser*, 312 B.R. 461, 465 (Bankr. D. Conn. 2004) (“pain of tortfeasor’s failure to adequately insure” was equitably shared between debtor and his creditors).

¹⁰⁰ See, e.g., *In re Bova*, 205 B.R. 467, 477 (Bankr. E.D. Pa. 1997); *In re Chavis*, 207 B.R. 845, 847 (Bankr. W.D. Pa. 1997) (“We note that Debtor is not required to choose one exemption under which to claim all aspects of a single personal injury award.”). For Personal Injury Exemption definition, see *supra* page 399.

¹⁰¹ *In re Wiley*, 184 B.R. 759, 766 (N.D. Iowa 1995); see also *In re Daly*, 344 B.R. 304, 318 (Bankr. M.D. Pa. 2005).

¹⁰² See *In re Daly*, 344 B.R. at 313 (debtor who had sustained separate injuries was not limited to single exemption under Personal Injury Exemption); see also *In re Comeaux*, 305 B.R. 802, 805 (Bankr. E.D. Tex. 2003) (same); but see *In re Christo*, 192 F.3d 36, 38 (1st Cir. 1999) (debtor entitled to only a single Personal Injury Exemption even though the debtor had three pending tort actions for three separate motor vehicle accidents).

Generally, personal injury awards are classified under the Personal Injury Exemption and reduced. The court considers the objective facts of the case and reduces the award accordingly. The award may be split into two categories, one portion under the Personal Injury Exemption (or a state law equivalent) and another portion under the Future Earnings Exemption.

Overall, the first issue shows that even with enumerated federal exemptions for different versions of disability benefits, courts classify awards differently which confuses debtors. Each type of disability benefit appears to be fit under at least two different exemptions. Depending on the facts of the case, the jurisdiction, and the type of disability benefit, the court may place the award in one exemption or another, split the award and place it under both exemptions, or place the award under no exemption. Further, state law exemptions only add to the confusion of an already muddled system. This current system unacceptably discriminates against disabled debtors based on their source of disability benefits and jurisdiction.

B. Second Issue: Temporal Limitations on Disability Benefits and Exemptions

Another major issue that arises for disability benefits is the timing of the award with the commencement of the bankruptcy case. The statutory language for all disability benefits is ambiguous as to whether the exemption extends to funds previously paid, whether the funds can be converted into goods and those goods exempt, and how long the exempt goods retain their exempt status. In general, disability benefits previously paid out retain their exempt status if the payments are from SSDI, private disability, or worker's compensation, but not personal injury. This practice preserves the fresh start for disabled debtors but there is some disagreement among the courts. Whether property purchased with disability proceeds is exempt depends on the type of benefit and how long ago it was received.

1. Funds Previously Paid

Generally, previously paid disability payments are exempt from the bankruptcy estate. Most courts follow the “‘general rule’ that depositing exempt funds into a bank account does not divest those funds of their exempt status.”¹⁰³ The general rule applies across multiple section 522(d) disability benefits, including SSDI, worker's compensation, private disability benefits. However,

¹⁰³ *In re Panza*, 219 B.R. 95, 97 (Bankr. W.D. Pa. 1998).

the general rule does not apply to personal injury.¹⁰⁴ “A disability benefit, (whether periodic or lump-sum payment), is not divested of its character as a payment in the nature of future earnings simply by virtue of its receipt by the beneficiary prior to the time the bankruptcy petition is filed.”¹⁰⁵ In this view there are no temporal limitations to disability benefits, simply “[t]he timing of the payment ought not deprive a recipient of those monies meant to be spent for his basic care and maintenance by eliminating the recipient’s right to exempt those funds.”¹⁰⁶

The reasons for exempting previously paid benefits include protection for debtors whose only source of income is disability benefits, protecting the fresh start, and rewarding debtors who save in anticipation of future large medical costs. One court reasoned that protecting the benefits allows for “deserving debtors who are receiving non-wage benefits at the same time they file for bankruptcy would receive the same treatment as debtors who are employed,” putting disabled debtors on equal footing even though “the right to receive payments acts as a substitute for future wages.”¹⁰⁷ This protection “permits the Debtor the opportunity to a fresh start.”¹⁰⁸ By exempting previously paid benefits, debtors avoid becoming destitute following a large medical bill or expense and rewards debtors who plan financially.

2. Conversion of Disability Benefits

Another temporal issue arises when cash benefits are comingled with other funds and converted to personal property. For private disability policies under section 522(d)(10), which includes the SSDI Exemption, the Disability Exemption, and the Contract Exemption, some courts hold that the exemptions apply in “pari passu to property that is traceable to that right.”¹⁰⁹ Courts reason that if the award is exempt and put to use by the debtor, the property should be exempt as well.¹¹⁰ This reasoning protects debtors who have large expenses and

¹⁰⁴ See *In re Chapman*, 177 B.R. 161, 163 (Bankr. D. Conn. 1994).

¹⁰⁵ *In re Frazier*, 116 B.R. 675, 678 (Bankr. W.D. Wis. 1990).

¹⁰⁶ *Id.*

¹⁰⁷ *In re McFarland*, 481 B.R. 242, 253 (Bankr. S.D. Ga. 2012), *aff’d sub nom.* *McFarland v. Wallace*, 516 B.R. 665 (S.D. Ga. 2014), *aff’d sub nom. In re McFarland*, 790 F.3d 1182 (11th Cir. 2015).

¹⁰⁸ *Id.*

¹⁰⁹ *In re Panza*, 219 B.R. 95, 96 (Bankr. W.D. Pa. 1998); see also *In re Ryzner*, 208 B.R. 568, 570 (Bankr. M.D. Fla. 1997) (interpreting Florida law that allows debtors to use exemptions in section 522(d)(10)); *In re Valentine*, No. 08-12074-JMD, 2009 WL 3336081, at *8 (Bankr. D.N.H. Oct. 14, 2009) (lump sum disability settlement would be exempt under section 522 (d)(10)); *In re Frazier*, 116 B.R. 675, 677 (Bankr. W.D. Wis. 1990); *In re Williams*, 171 B.R. 451, 453–54 (D.N.H. 1994) (interpreting New Hampshire law); *In re Greene*, 178 B.R. 533, 536 (Bankr. M.D. Fla. 1995) (interpreting Florida law).

¹¹⁰ *In re Williams*, 171 B.R. at 454.

must use their disability benefits for their own maintenance and support, rather than saving.

Courts may disagree with the general rule and hold that once deposited and converted, the creditors may reach the property that was based on the benefit.¹¹¹ Courts reason that the exemptions in section 522(d)(10) differ from other exemptions because it only exempts “a debtor’s right to receive” and does not include “property that is traceable” like the exemptions found in section 522(d)(11), which includes the Personal Injury Exemption and the Future Earnings Exemption.¹¹² This line of reasoning shows that debtors could end up exempting their entire bankruptcy estate if disability benefits were the debtor’s sole source of income for a long period of time, leaving creditors with no property or funds for repayment in the bankruptcy estate.¹¹³ In an illustrative case, a debtor tried to exempt \$11,233.94 in fur coats because they had been purchased with disability payments.¹¹⁴ The court disagreed and did not let the debtor exempt the fur coats.¹¹⁵

3. *Workers’ Compensation*

Workers’ compensation awards present unique temporal issues. Under the Future Earnings Exemption debtors may exempt their “right to receive, or property that is traceable to . . . a payment in compensation of loss of future earnings.”¹¹⁶ It is unknown whether Congress intended future earnings to be measured by the date of filing or by the date of the debtor’s claim.¹¹⁷ One court reasoned that if Congress intended it to be from the petition date, in cases where the award has not yet been determined, then no portion of the award would be exempt, defeating the purpose of the exemption.¹¹⁸ In an illustrative case, when a debtor filed for bankruptcy just prior to receiving a \$173,679.49 workers’ compensation award for loss of a hand, the court deemed the entire award exempt but said it could be exempt under the Disability Exemption or the Future Earnings Exemption.¹¹⁹

¹¹¹ *In re Panza*, 219 B.R. at 96; *In re Chapman*, 177 B.R. 161, 163 (Bankr. D. Conn. 1994).

¹¹² *In re Panza*, 219 B.R. at 97 (citing 11 U.S.C. § 522(d)(10) (2019); *id.* § 522(d)(11)).

¹¹³ *See id.* at 95.

¹¹⁴ *Id.* at 98.

¹¹⁵ *Id.*

¹¹⁶ 11 U.S.C. § 522(d)(11)(E).

¹¹⁷ *See In re Herald*, 294 B.R. 440, 448 (Bankr. W.D.N.Y. 2003).

¹¹⁸ *See id.*

¹¹⁹ *In re Hanh Hieu Dang*, 473 B.R. 218, 221–22 (Bankr. W.D. Mich. 2012).

Although the Future Earnings Exemption exempts workers' compensation awards and "property that is traceable" to the award, the property is not always exempt.¹²⁰ As a general matter, when considering whether a debtor's workers' compensation award is exempt under this rule, the court tends to favor the exemption of a recently received award over that of an old award.¹²¹ Further, when a debtor converts his workers' compensation award into consumer goods, the court is less likely to exempt the goods obtained through the award's conversion than the original award itself.¹²² In an illustrative case, the court held that the lump-sum workers' compensation award that the debtor received four years prior, and subsequently used to purchase a vehicle and outdoor equipment, was not exempt under the Future Earnings Exemption.¹²³ The court furthered that remaining cash from the award that the debtor deposited in a bank account, but did not spend, was not exempt under the Disability Exemption because the debtor failed to represent a "right to receive" a disability benefit.¹²⁴ Thus, both the goods and the remaining proceeds that the debtor derived from the award were available to creditors, absent some other possible exemptions.¹²⁵

State law issues also arise when workers' compensation awards are converted into consumer goods. Some states offer more protection than others. For example, New Hampshire and Illinois state law allow an automobile purchased with workers' compensation funds to be exempt,¹²⁶ while Rhode Island law does not permit such an exemption.¹²⁷ As evidenced by these conflicting standards, the treatment of workers' compensation awards vary greatly from state-to-state because state law is, as a whole, an extremely variable body of rules. As one court aptly explained, although "[s]tatutes exempting

¹²⁰ 11 U.S.C. § 522(d)(11)(E).

¹²¹ See *In re Nielsen*, 401 B.R. 149, 150 (Bankr. M.D. Pa. 2009) (court exempts lump sum award received post-petition, pre-confirmation); *Matter of Evans*, 29 B.R. 336, 339 (Bankr. D.N.J. 1983) (pending workers' compensation award exempt entirely); *In re Covey*, 36 B.R. 696, 698 (Bankr. W.D. Ark. 1984) (court exempts lump sum award received three months prior to bankruptcy petition); *In re Michael*, 262 B.R. 296, 299 (Bankr. M.D. Pa. 2001) (court denies exemption to lump sum award received over a year prior to bankruptcy petition); *In re Sanchez*, 362 B.R. 342, 361 (Bankr. W.D. Mich. 2007) (court only exempts portion of award received a year prior to bankruptcy petition).

¹²² See *In re Wydner*, 454 B.R. 565, 574 (Bankr. W.D.N.Y. 2011) (court denies exemption to debtor who spent workers' compensation settlement on items such as a large screen television, elective gastric bypass surgery, and new carpeting); *In re Covey*, 36 B.R. at 698 (court exempts segregated lump sum award).

¹²³ *In re Williams*, 181 B.R. 298, 301–02 (Bankr. W.D. Mich. 1995).

¹²⁴ *Id.*

¹²⁵ *Id.* at 301.

¹²⁶ See, e.g., *In re Williams*, 171 B.R. 451, 452, 454 (D.N.H. 1994) (holding that one debtor could exempt an automobile that was purchased with workers compensation); *In re Irwin*, 371 B.R. 344, 346 (Bankr. C.D. Ill. 2007) (same).

¹²⁷ See, e.g., *In re Bonzey*, 153 B.R. 105, 107 (Bankr. D.R.I. 1993) (holding that once the debtor received workers' compensation the exemptions are no longer applicable).

worker's [*sic*] compensation benefits from creditors' claim vary markedly from state to state . . . judicial interpretation of those laws is even more varied."¹²⁸

In summary, all sources of disability benefits face a variety of complex temporal issues and the lack of clear precedent surrounding the treatment of these issues only exacerbates confusion for debtors. More specifically, a disabled debtor's unique circumstances can affect the court's treatment of the debtor—such as (1) the source of the debtor's disability benefits, (2) whether the debtor has fully used or converted his or her benefit funds, and (3) how long ago the debtor received such benefits. This lack of uniformity encourages disabled debtors to spend their full award payments, rather than engaging in intelligent, long-term financial planning, because they do not know whether the money that they save will be exempt.

C. Third Issue: Form of Disability Benefit

The manner in which disability benefits are dispersed can also create issues for the debtors who rely on such payments to survive. Benefits can take the form of annuities, pensions, trusts, and insurance policies. Unlike the debtors receiving this wide array of disability benefits, this issue of inconsistent payment form does not affect recipients of SSDI, whose disability benefits are always distributed through a uniform monthly check system. However, the issue does arise for private disability policies, workers' compensation, and personal injury. This Section will demonstrate that the current system unfairly discriminates against disabled debtors based on the form of their disability benefit.

1. Private Disability Policies

Private disability benefits come in forms including annuities, pensions, trusts, and insurance policies.¹²⁹ Courts may place these different benefit payment policies under the Contract Exemption,¹³⁰ which allows debtors to exempt their right to receive “a payment under . . . a pension . . . or similar plan or contract on account of illness, disability, death, age or length of service, to the extent reasonably necessary for the support of the debtor,” rather than under the

¹²⁸ *In re Nolen*, 65 B.R. 1014, 1015 (Bankr. D.N.M. 1986).

¹²⁹ *See In re Aubry*, 558 B.R. 333, 342 (Bankr. C.D. Cal. 2016); *In re Donaghy*, 11 B.R. 677, 679 (Bankr. S.D.N.Y. 1981); *In re Bowen*, 458 B.R. 918, 919 (Bankr. C.D. Ill. 2011); *In re McQuaid*, 492 B.R. 514, 515 (Bankr. N.D. Ill. 2013).

¹³⁰ *See supra* note 126.

Disability Exemption, because the benefits are more contractual in nature, and less like a cash disability benefit.¹³¹

In a notable case, the court allowed an elderly debtor to fully exempt his lump sum disability payment, which he opted to receive over a stream of future payments to pay his ailing wife's medical bills.¹³² However, trusts are not afforded the same preferential treatment as lump sum disability payments. For example, under Illinois law, debtors could not exempt a special needs trust that was created through the debtors' successful lawsuit against a disability insurer that initially denied payment.¹³³ Because the debtor only claimed the trust under the exemption under a right to receive disability proceeds and not under any exemption for already received payments, it was placed in the bankruptcy estate.¹³⁴ However, based on the same statute, another court held that a private disability insurance policy was exempt even though it can be argued the special needs trust was only created because there was an initial right to receive disability proceeds.¹³⁵

2. *Workers' Compensation*

A court may place workers' compensation awards that do not take the form of cash under the Future Earnings Exemption.¹³⁶ A court interpreting a Missouri state statute—which is nearly identical to the Future Earnings Exemption—held that an annuity purchased on behalf of a debtor for a workers' compensation claim had to be limited to the amount reasonably necessary for support, in contrast to a cash payment made under the Disability Exemption.¹³⁷ Another court further reasoned that the debtor may not use the Disability Exemption when his or her workers' compensation award has already been deposited.¹³⁸ In cases like these, the award instead must be grouped under the Future Earnings Exemption.¹³⁹

However, the conclusion that the Disability Exemption falls under the umbrella of the Future Earnings Exemption has not been upheld by all courts.

¹³¹ 11 U.S.C. § 522(d)(10)(E) (2019).

¹³² *In re Donaghy*, 11 B.R. 677, 680 (Bankr. S.D.N.Y. 1981).

¹³³ *In re McQuaid*, 492 B.R. 514, 515, 518 (Bankr. N.D. Ill. 2013); *see* 735 Ill. Comp. Stat. Ann. 5/12-1001 (2019) (exempting a debtor's right to receive "a disability, illness, or unemployment benefit").

¹³⁴ *In re McQuaid*, 492 B.R. at 515–18.

¹³⁵ *In re Bowen*, 458 B.R. 918, 923 (Bankr. C.D. Ill. 2011)

¹³⁶ *See, e.g., In re Bonuchi*, 322 B.R. 868, 874 (Bankr. W.D. Mo. 2005).

¹³⁷ *Id.*; *see* Mo. Rev. Stat. § 513.430 (2020).

¹³⁸ *See In re Sanchez*, 362 B.R. 342, 357 (Bankr. W.D. Mich. 2007).

¹³⁹ *See In re Arellano*, 524 B.R. 615, 618 (Bankr. M.D. Pa. 2015).

Interpreting California law that is identical to the Code, a court determined that an annuity paid to a debtor who could not return to work for ten years following a workplace injury was exempt as a disability benefit, rather than a right to receive payment.¹⁴⁰ Moreover, while lump sum payments may also be an issue, courts generally hold such payments to be exempt.¹⁴¹ For instance, when a debtor purchased a certificate of deposit for a workers' compensation award of \$84,000, distributed as a lump sum, a court deemed the award to be exempt.¹⁴²

In summary, the form of the disability benefit can affect how the disability benefit is treated by courts. The form might ultimately impose unfair discrimination against a debtor who either intentionally selects a certain benefit type for financial planning purposes or involuntarily gets stuck with a benefit type that she would not otherwise choose. This discrimination is arbitrary, as the form of a disability benefit should not affect the status or classification of its potential exemption.

Overall, three main issues plague disability benefits: (1) confusion as to where to place the award, (2) temporal constraints and confusion, and (3) form of the disability payment issues. This current system has led to chaos for disabled debtors. Will the disability payments be exempt in full, partially, or not all? Will any saved amounts of the disability benefit be exempt? What if the disability benefit comes in a different form than a monthly check? All of these answers depend on the court hearing the case, even in non-opt out states.

III. PROPOSED AMENDMENTS

The current exemption system for disability benefits can be amended on several levels. This Section proposes defining a disability benefit in section 101 of the Code, modifying the opt-out system to eliminate state law exemptions for disability benefits, and redrafting the troublesome portions of section 522(d). This Section will then demonstrate how the proposed system aligns with other Code provisions and other areas of law. Finally, this Section will demonstrate the equity of the proposed system by comparing it to the current Code.

¹⁴⁰ *In re Aubry*, 558 B.R. 333, 344, 352 (Bankr. C.D. Cal. 2016); *see* CAL. CIV. PROC. CODE § 703.140 (West 2020).

¹⁴¹ *See, e.g., In re Nolen*, 65 B.R. 1014, 1014–16, 1018 (Bankr. D.N.M. 1986) (describing the treatment of lump sum payments by various state courts); *In re Willis*, No. 93-31512-B, 1994 WL 69517, at *2–4 (Bankr. W.D. Tenn. Feb. 14, 1994) (noting that workers' compensation benefits are exempt and not limited a certain amount); *In re Jones*, 446 B.R. 466, 474 (Bankr. D. Kan. 2011) (final annuity lump sum payment fully exempt).

¹⁴² *In re Greene*, 178 B.R. 533, 537 (Bankr. M.D. Fla. 1995).

A. *Amendments to the Bankruptcy Code*

There are three changes that need to be made in the Code to better serve disabled debtors. The changes would include defining a disability benefit in section 101, modifying the opt-out scheme in section 522(b)(1), and redrafting section 522(d).

1. *Defining a Disability Benefit*

The first step is to define a disability benefit in section 101 of the Code. The term disability benefit can potentially implicate five different exemptions in section 522(d) depending on the circumstances of the case. Defining disability benefits in section 101 would clear up meaningful confusion in section 522(d). The proposed definition would read:

(13B) The term “disability benefit” means a right to reasonable payment that accrues before, on, or after the date of the order for relief in a case under this title that is:

(A) a substitute to income when an individual cannot perform a substantial amount of work due to injury or long-term illness expected to last at least 12 months; and

(B) takes the form of an identifiable method of support.

2. *Modifying the Opt-Out Scheme*

Second, the opt-out scheme should be modified in section 522(b)(1). An exception would be added to so that no state laws can change the disability exemption system set out in the remainder of Section 522(d). The proposed modification to Section 522(b)(1) is as follows:

Notwithstanding Section 541 of this title, an individual debtor may exempt from property of the estate the property listed in either paragraph 2, or in the alternative, paragraph (3) of this subsection *except for a disability benefit that meets the definition in 101(13B) in which case a debtor may only use paragraph (3) of this subsection.*¹⁴³

This proposed statutory language would eliminate the state law exemption scheme that causes confusion for disability benefits only.¹⁴⁴ This modification would create uniformity for disabled debtors by ensuring that courts must use the exemptions in section 522(d) only. This would prevent courts from apply

¹⁴³ 11 U.S.C. § 522(b)(1) (2019). The portion in italics is the proposed amendment.

¹⁴⁴ The integrity of opt-out system for exemptions other than disability exemptions exceeds the scope of this comment.

state disability benefit exemptions that could be broader or narrower than the federal exemptions, which leads to geographical discrimination depending on a disabled debtor's residency.

3. Redrafting Section 522(d)

Third, the statutory language of section 522(d) would be reworked. First, all types of disability benefits would be grouped together, including private disability benefits, worker's compensation, and SSDI provided they meet the definition of a disability benefit in proposed section 101(13B). The statutory language will incorporate a general rule for future payments, past payments, form, property purchased with the award, and any punitive elements. This Subsection will discuss the proposed changes and then recommend statutory amendments.

a. Form

The form of the disability benefit should not matter if the benefit meets the proposed definition of a disability benefit in Section 101. The benefit could be in the form of a lump sum settlement, annuity, monthly cash payments, or held in a trust.

b. Future Payments

Next, future payments should be limited to an amount reasonably necessary for support of the debtor. This would prevent any unreasonably large payments from exemption. This would also prevent punitive components of awards from exemption. Instead, any punitive element would be distributed as a part of the estate. Limiting future payments is not only fair to creditors, but also follows disability payment's treatment under the Tax Code.¹⁴⁵ Additionally, to combat some of the temporal issues, if a debtor must wait for a payout between his injury and his award, that time period should not be reduced. Since this portion of disability benefits, regardless of form, generally covers expenses like medical costs and lost wages for that period, it should not be reduced so that the debtor can pay down those expenses. This distinction would not include any special damages for that time period.

¹⁴⁵ See PUBLICATION 907, TAX HIGHLIGHTS FOR PERSONS WITH DISABILITIES, IRS, <https://www.irs.gov/publications/p907> (last visited Jan. 10, 2021).

c. Past Payments

Under the new proposed system, previously paid funds under a disability benefit plan would retain their exempt status. This treatment aligns all disability benefits with SSDI.¹⁴⁶ Exempting previously deposited funds prevents pre-bankruptcy planning of converting cash into exempt assets. This system further rewards smart financial planning and rewards debtors who save. However, this would not be the case for personal injury awards. The portion of a personal injury award that represents the debtor's physical disability and inability to keep working should be exempt in the entirety. However, the remaining portion of the award should be reduced according to the Personal Injury Exemption. Because the source of funds itself is exempt, the funds should remain exempt until converted into another asset. This strikes a fair balance between debtors and creditors; a debtor may exempt the funds if they are still identifiable proceeds of a disability benefit but may not once the award is converted to goods.

d. Property Purchased with a Disability Benefit

However, any exemption for property that is traceable to a disability benefit would be discarded. The exemption for property traceable to an award can harm creditors because a debtor could exempt her entire estate under certain circumstances. For example, if the debtor was receiving disability benefits for several years, a majority of the debtor's estate could be exempt. The other exemptions in section 522 offer the debtor sufficient protection outside of section 522(d).¹⁴⁷ Further, if the purpose of disability benefits is to serve as an income substitute for a disabled individual, then the individual should be treated the same as a non-disabled individual. Typical debtors cannot exempt their entire estate simply because the goods were purchased using funds from their paycheck.

e. Section 522(d) Amendments

All of these recommendations should be written into section 522(d). To start, the word "disability" should be removed from section 522(d)(10)(C) and section 522(d)(10)(E) and a new section 522(d)(10)(F) that would encompass all disability benefits should be created. The proposed new statutory language is as follows:

¹⁴⁶ See Social Security Act, 42 U.S.C.A. § 407 (West).

¹⁴⁷ See generally 11 U.S.C. § 522 (listing exemptions).

(F) The debtor's right to receive a Disability Benefit to the extent it is reasonably necessary for support of the debtor and any dependent of the debtor in any identifiable form

(i) including deposited funds previously paid out to the extent the funds are identifiable proceeds of the debtor's right to receive a Disability Benefit;

(ii) excluding property that is traceable to the debtor's right to receive a Disability Benefit; and

(iii) this section does not limit an award of previously unaccounted for Disability Benefits that represent general damages.

This rework of section 522(d)(10) combats the confusion surrounding disability benefits. Section 522(d)(11) would be left in its entirety, which covers workers' compensation. If a workers' compensation award qualifies as a Disability Benefit under the newly proposed definition, then the court should use the newly proposed section 522(d)(10)(F) exemption scheme. If the workers' compensation award does not meet the definition, it should be placed under section 522(d)(11). This treatment is the same for personal injury awards under the Personal Injury Exemption. Specifically, if a personal injury award does not compensate for a disability, is predominately punitive, or has no physical element, then the award should remain under section 522(d)(11)(D).

This choice between two statutory options for workers' compensation and personal injury awards may not seem ideal given the current issues highlighted by this Comment. However, the courts currently lack a definition for disability benefits altogether. Thus, in creating such a definition, courts should place disability benefits that meet the definition under the new proposed system while classifying workers' compensation and personal injury awards under the exemptions set out for each issue.

In conclusion, these proposed statutory amendments would align the Code with court decisions and treat all disability benefits equally. The amendments would also allow the court to make an objective determination about the future benefits and whether the benefits need to be limited. The proposed statutory amendments solve the problem with disability benefits in multiple ways. First, defining a disability benefit guides courts initially by allowing judges to compare the benefit a debtor receives to the new definition. If the benefit falls within the definition, the newly proposed section 522(d)(10)(F) applies. Further, if the statutory opt-out scheme is eliminated, it would allow the court to disregard any contrary state laws.

IV. APPLICATION

This Section will walk Joe the debtor through the current system for disability related benefits and through the new proposed system. This application will demonstrate the new proposed system's fairness, reliability, and easy use.

Returning to the hypothetical posed at the beginning of this comment, Joe was injured at work and struggled to pay the bills. Joe file for bankruptcy. Under the current system, if Joe is not receiving SSDI, his award has temporal, placement, and form issues. Suppose Joe's disability payments come from a private disability policy and he receives \$800 a month in the form of a check. First, Joe does not know where the court will place his award. Will it be categorized under the Disability Exemption, and be fully exempt, or under the Contract Exemption, and reduced? The form of the award will also factor into its categorization. If the award is money, the court is most likely to place it under the Disability Exemption.¹⁴⁸ If the award is in another form, then the court will mostly likely place it under the Contract Exemption instead.¹⁴⁹ Suppose Joe saved \$5,000 of his disability benefit before filing for bankruptcy relief. If the saved funds were not exempt, would Joe use them to purchase exempt assets rather than have the funds taken away by the court? The courts are split as to whether goods purchased with disability benefits are exempt.¹⁵⁰

Now, Bob. Suppose Bob received a workers' compensation award, rather than a private disability policy, and through that award, he was paid \$800 per month. Similar to Joe, Bob would not know how the court will classify the award. Facing two possibilities, Bob's award could be placed under the Disability Exemption or placed under the Future Earnings. The form of Bob's workers' compensation award may also matter. If the award is \$800 in cash, then the benefit will most likely fall under the umbrella of the Disability Exemption. Alternatively, if the award is not cash, then the benefit is likely to be classified within Future Earnings Exemption. Moreover, temporal issues also play into your workers' compensation award. Suppose that Bob received a lump sum payout two years ago, rather than monthly payments. Some courts would allow the award to remain exempt, while others would deem it to be too far in the past

¹⁴⁸ See *In re Cain*, 91 B.R. 182, 183 (Bankr. N.D. Ga. 1988) (workers' compensation benefits exempt under Disability Exemption because they are statutorily designed as reasonably necessary for the debtor's support).

¹⁴⁹ See *In re Greenly*, 481 B.R. 299, 317 (Bankr. E.D. Pa. 2012) (annuity payments debtor was entitled to in connection with structured settlement arose out of contract and the debtor did not own the annuity herself, so the court placed the award under the Contract Exemption rather than the Disability Exemption).

¹⁵⁰ *Supra* notes 109–115 and accompanying text.

for an exemption even if you kept the money segregated and refrained from spending.¹⁵¹ Suppose instead, however, that Bob spent the money on other property. In this scenario, such property is not exempt, absent some other applicable exemption.¹⁵²

Finally, Suzy. Suppose Suzy received a personal injury award, in a payment of \$30,000. Similar to private disability and worker's compensation, Suzy would not know where the court will place her award under these circumstances. The court may place it under the Personal Injury Exemption or under the Future Earnings Exemption, but, in either case, the award may also be reduced. Form also plays into personal injury awards. For example, if Suzy's award is not a \$30,000 check but is instead an annuity, then the award may be classified as worker's compensation. This may allow Suzy to keep more of the award over time, rather than having the \$30,000 reduced. However, if Suzy received the \$30,000 award in place of the annuity, then she would have an incentive to convert the award into as much exempt property as possible, for the sake of keeping the majority of the award.

Now as a comparison, suppose Joe was receiving \$800 a month as a disability benefit. Under the new proposed system, the source of Joe's disability benefit would not matter as long as it met the proposed definition. If Joe could not perform a substantial amount of work due to injury or long-term illness expected to last at least twelve months and the disability benefit took the form of an identifiable method of support, Joe's award would be classified as a disability benefit. This new definition immediately eliminates any form issues, so if the payments were not in a monthly check, it would not matter.

The new system also clears up any confusion on temporal issues. Any future payments under Joe's disability policy could be reduced by the court to the amount reasonably necessary to support Joe. This is a compromise. The court *may* reduce the award but is not required to. Further, this gives the court discretion to consider the individual aspects of each case, such as anticipated medical costs and potential to return to work. While future payments may be reduced, the court may not limit any portion of an award that compensates the debtor for the time between their injury and the award.

Under the new system, property that is traceable to the award is not exempt. If Joe purchased any property with his award, the property would not be exempt. This eliminates the possibility of debtors being able to exempt their entire estate

¹⁵¹ *Supra* notes 120–125 and accompanying text.

¹⁵² *See* 11 U.S.C. § 522 (2019) (listing exemptions).

if all assets were purchased using the disability benefit. This unfairly discriminates against creditors and would result in creditors refusing to extend credit to any disabled individuals. This is not worth the risk. However, funds previously paid and not yet spent are exempt. This promotes financial planning by the disabled debtor.

Bob and Suzy have similar results to Joe under the proposed system. Bob's \$800 workers' compensation award would be classified as a disability benefit if he could not perform a substantial amount of work due to injury or long-term illness expected to last at least twelve months. The form of Bob's worker's compensation would not matter if the benefit took the form of an identifiable method of support. When Bob received his award would not matter either under the proposed system. Suzy faces similar results to Joe and Bob. Her personal injury award would be classified as a disability benefit if it met the definition, regardless of whether it is a lump sum or an annuity.

While there are some tradeoffs in the proposed system, it is straightforward, and a debtor would know the status of his disability benefit rather than guessing. The new proposed system eliminates many of the pitfalls of the current system but still allows the court to carefully consider each disabled debtor's unique situation.

CONCLUSION

The current exemption system for disability benefits needs to be amended. First, the archaic opt-out system allowed states to write their own exemptions and meddle with what is otherwise a uniform bankruptcy process. Even if states are not allowed to opt-out of the federal exemptions, the exemptions are poorly drafted, confusing, and difficult to apply. Given sparse source material, the courts understandably struggle to apply the federal exemption system. The result of this system is a disorderly and discriminatory system for disabled debtors.

Disabled debtors face numerous uncertainties about their disability benefits. The court does not know which exemption to use for which type of disability benefit, which affects if the award is reduced or exempt in full. The second largest issue is temporal limitations. Are the future benefits exempt? What about the current funds and assets purchased with the funds? Finally, what about funds previously paid? Another issue is the form of the disability benefit. Courts do not like benefits that are not paid in cash and allows form to play into classification of the award.

The new proposed system eliminates all three main issues courts currently face. The proposed system eliminates confusion on classification by defining a disability benefit and drafting a new exemption exclusively for disability benefits. The new exemption and definition apply regardless of the source of the disability benefit. The new definition eliminates any form issues. As long as the disability benefit meets the definition, it is exempt regardless of form. Further, the new system eliminates the confusion on temporal issues by creating clean cut rules. Future payments may be reduced, funds retain their exempt status when paid but property purchased with the funds does not. This strikes a balance between creditors and debtors and will best serve disabled individuals in the future.

Finally, the new system's clarity is demonstrated by the application section. Instead of confusion for the disabled debtor, a simplified system offers logical rules that allow debtors to adequately plan and maximize the value of their estate to the benefit of creditors. This system will enable disabled debtors to use the bankruptcy courts in an orderly, fair, and predictable fashion.

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