

Decision Removes Uncertainty About Protecting Workers' Comp Awards

By **Craig D. Robins**

Up until 2011, there was a belief among consumer bankruptcy practitioners in our district that workers' compensation benefits were totally exempt and fully protected. Two sections of the New York Debtor and Creditor Law (§§ 282 and 283) appeared to provide for that.

However, in 2011, a judge in the Western District of New York decided that a workers' compensation disability payment that the debtor receives before the bankruptcy is filed is not exempt. *In re Wydner*, 454 B.R. 565.

This opinion created a great deal of con-



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cern and uncertainty here. Often a potential client has a situation in which they are entitled to a lump sum worker's compensation award, and they have already received it. If the client files a petition and seeks to exempt these funds, will the trustee argue that they are not protected, relying on *Wydner*? Or

will the trustee let it go because there is no case law on this issue in the Eastern District of New York, and exemption statutes in general seem to favor protecting disability awards?

The former was the scenario eventually presented to Judge Louis A. Scarcella, sitting in the Central Islip Bankruptcy

Court, who just issued a decision on Oct. 16, 2019. *In re Naura*, Case No.18-75891-las (Bankr. E.D.N.Y.). Here, the debtor suffered a permanent partial disability relating to the use of his leg due to an accident that occurred in 2012. Prior to filing the bankruptcy case, the debtor received a WC compensation check for \$45,000. The debtor had not yet cashed the check so there was no issue of commingling funds.

The debtor eventually claimed that the WC award is exempt under NYDCL § 282(2)(c), Work. Comp. Law §§ 33 and 218(2), and Labor Law § 595(2). However, the trustee, Andrew M. Thaler, filed a motion objecting to the exemptions. He did not dispute that disability and WC benefits are generally exempt outside of bankrupt-

cy and that they would be exempt if made payable or earned after the bankruptcy filing. However, he contended that benefit payments received by a debtor prior to filing are not exempt, based on *Wydner*.

The dispute in *Wydner* was whether the debtor could exempt a lump sum WC award received before commencement of the bankruptcy case. The *Wydner* court said no, basing its decision on a murky interpretation of the wording in NYDCL § 282(2)(c). The issue was, what does the phrase, "the debtor's interest in," ultimately mean? This led that court to then go beyond the "ambiguous" statutory text to consider the legislative history. The de-

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cision was controversial and many attorneys did not think it was good law.

However, Mr. Thaler urged our court to consider it. In short, the trustee argued that although payments received pre-petition are exempt under state law, that is not the case in bankruptcy. Instead, according to the trustee, such payments should be viewed as cash, with the source and reason for payment being irrelevant *unless* the payment is received post-petition.

In his 22-page written decision, Judge Scarcella initially noted some basic concepts. The trustee bears the burden of proving that the debtor's claimed exemption is improper. The purpose of exemptions is to provide a debtor with a fresh new start and they are a critical component to this basic bankruptcy principle. Exemption statutes are to be construed liberally in the debtor's favor.

The judge then discussed the exemption statutes. Work. Comp. Law §§ 33 and 218(2), and Labor Law § 595(2) all essentially provide that compensation or disability benefits due shall be exempt from

all claims of creditors.

The judge stated that when a debtor files for bankruptcy in New York and elects to claim exemptions under the New York exemption scheme, the applicable state exemptions are set forth in NYDCL §§ 282 and 283. These provisions protect the right to receive benefits. In discussing these statutes, the judge commented that the public policy behind protecting disability and WC awards from the reach of creditors is a long standing one.

In working through an analysis, Judge Scarcella delved deep into the same *Wydner* issue concerning statutory interpretation. He drew the opposite conclusion that the *Wydner* court found. Judge Scarcella stated that he disagreed with the *Wydner* court's conclusion that the applicable statute is ambiguous. He stated that it is plain on its face.

Judge Scarcella went so far as to comment that "in short, the trustee asks this court to rewrite the statute, which is neither silent nor unclear on the question at issue." He also opined that "the trustee's

reading unreasonably restricts application of NYDCL § 282(2) and defeats the purpose of the statute. Additionally, the outcome advocated by the trustee undermines the distinct social policies why we have exemption laws in the first place and countermands the protection given a debtor entitled to a disability benefits."

Thus, in handing the debtor a big win, Judge Scarcella removed the uncertainty that our jurisdiction has had to deal with for the better part of a decade concerning whether some WC awards were exempt or not.

However, he did not stop there, stating that "if called upon to rule on whether a workers' compensation payment received in a lump sum pre-petition may properly be claimed as exempt under § 522(d), this court would comfortably find that a workers' compensation payment received as a lump sum pre-petition can qualify for the exemption permitted under § 522(d)(11)(E) when the § 522(d)(10)(C) exemption is not available.

Kudos to Judge Scarcella for going above and beyond. The *Wydner* decision

had created great uncertainty. Judge Scarcella not only resolved that but clarified the issue that WC proceeds are exempt, whether the debtor uses the state or federal exemptions. It is nice when the court provides clarity to counsel for how to maneuver through a certain issue, which is greatly appreciated by the bankruptcy bar.

Practice Tip. In order to preserve the exemption, it is important that the debtor does not commingle the exempt funds with nonexempt funds as doing so will likely lead a court to conclude that the funds have lost their character as exempt funds.

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