

**IN THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF ARKANSAS
FAYETTEVILLE DIVISION**

IN RE: TRAVIS JAMES KERSHNER, Debtor

**No. 5:08-bk-70818
Ch. 7**

ORDER

Before the Court is the Objection to Exemption filed by National Home Centers, Inc. [National] on June 10, 2008. In its objection, National objected to the debtor's claim of an exemption under 11 U.S.C. § 522(d)(10)(E) relating to a "District Manager's Appointment Agreement" [Agreement] between the debtor/District Manager and Farmers Insurance Exchange, Truck Insurance Exchange, Fire Insurance Exchange, Mid-Century Insurance Company, Farmers New World Life Insurance Company, and Farmers Insurance Group, Inc. [Farmers]. The Court held a hearing on the objection on August 4, 2008. At the conclusion of the hearing, the Court took the objection under advisement and allowed the parties an additional 30 days to submit post-hearing briefs. For the reasons stated below, the Court sustains National's objection to the claimed exemption.

Jurisdiction

The Court has jurisdiction over this matter under 28 U.S.C. § 1334 and 28 U.S.C. § 157, and it is a core proceeding under 28 U.S.C. § 157(b)(2)(B). The following opinion constitutes findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052, made applicable to this proceeding under Federal Rule of Bankruptcy Procedure 9014.

Background

On October 4, 1999, the debtor and Farmers entered into the Agreement, which was effective as of July 1, 1999. The Agreement recites two methods of compensation for the debtor that are the subject of this order: (1) a monthly compensation "[t]o pay the District Manager an overwrite on all business produced by Agents of, and written by the

Exchanges, Mid-Century and Farmers New World Life, in the District”; and (2) a Contract Value to be paid to the debtor, his personal representative, or heirs “[i]n the event of cancellation or other termination of the agency created hereby for any reason whatsoever . . .” subject to certain enumerated exceptions:

that in the event of fraud or embezzlement of funds of any of the Companies by the District manager, or the failure to promptly remit any funds in accordance with prescribed rules, or the contacting, directly or indirectly, of any policyholder of any of the Companies for the purpose of switching insurance, or in the event of willful misrepresentation by the District Manager on an application, or in the event of his/her abandonment of the District, the Companies may cancel immediately or may, at their option, and without notice to the District Manager, consider the Appointment Agreement immediately cancelled and terminated by the District Manager.

Contract Value is based on the service commission overwrite paid to the debtor during the six months immediately preceding termination and the number of years of service the debtor served as district manager according to a schedule set forth in the Agreement. The debtor testified that he is paid approximately \$35,000 to \$40,000 a month under the monthly compensation section of the Agreement, and that the Contract Value is currently valued between \$530,000 and \$540,000. He also testified that he is able to borrow against the Contract Value up to 50% of its value, that he last borrowed against the Contract Value three years earlier, and that the current value of the remaining equity is between \$250,000 and \$280,000. On cross examination, the debtor testified that the remaining equity was valued at \$250,000. The debtor listed the Agreement on Schedule C of his bankruptcy petition and claimed 100% of the Agreement exempt under § 522(d)(10)(E). The debtor also noted on Schedule C that, “This asset has NO MARKET VALUE and debtor asserts is not property of the estate.”

National objected to the debtor’s claim of exemption in the Agreement and argues that the Agreement is property of the estate and the monthly compensation the debtor receives as an overwrite of all policies issued in his district “most likely” comes from policies sold pre-petition. As such, the monthly compensation paid to the debtor should be characterized as proceeds from property of the estate under § 541(a)(6). Additionally,

National argues in its post-hearing brief that because the monthly income the debtor receives post-petition is not from the personal services performed by the debtor, it should be included in the debtor's estate for distribution to unsecured creditors.

Findings of Fact and Conclusions of Law

Commencement of a bankruptcy case creates an estate comprised of, among other things, all legal and equitable interests of the debtor in property. *See* 11 U.S.C. § 541(a)(1). Contracts held by the debtor, including the Agreement at issue in this case, and any pre-petition earnings derived from those contracts become property of the estate upon filing of the petition. *Hutchins v. Fordyce Bank & Trust Co. (In re Hutchins)*, 211 B.R. 325, 327 (Bank. E.D. Ark. 1997). Further, even though the Contract Value may be contingent at the time of filing and not payable until the debtor's appointment is either terminated or cancelled, it is a legally recognizable interest and also part of the debtor's estate. *Potter v. Drewes (In re Potter)*, 228 B.R. 422, 423-24 (B.A.P. 8th Cir. 1999)(recognizing that courts have consistently held that § 541 applies to contingent interests); *Rau v. Ryerson (In re Ryerson)*, 739 F.2d 1423, 1425 (9th Cir. 1984)(same); *cf. In re Flippin*, 334 B.R. 434, 436 (Bankr. W.D. Ark. 2005)(finding debtor's inchoate dower interest is property of the estate). Accordingly, the Court finds that the Agreement is property of the debtor's estate.

The Agreement consists of two parts identified as monthly compensation and termination pay or Contract Value. Because National objected to the exemption of the entire Agreement under § 522(d)(10)(E), the Court will review each part individually to determine the applicability of that section. According to the bankruptcy code, a debtor may exempt from his bankruptcy estate his "right to receive . . . a payment under a stock bonus, pension, profitsharing, annuity, 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 and any dependent of the debtor" 11 U.S.C. § 522(d)(10)(E).

Monthly Compensation

With regard to the monthly compensation, the debtor testified that the compensation is based on business produced by agents within the debtor's territory. In exchange, the debtor operates under a specific set of goals and objectives that are lined out each year. Although "[p]roceeds, product, offspring, rents, or profits of or from property of the estate" are also property of the estate, the code excepts "earnings from services performed by an individual debtor after the commencement of the case." 11 U.S.C. § 541(a)(6). To the extent the services were performed pre-petition, the compensation received for those services, even if paid post-petition, are property of the estate. If the debtor had claimed the pre-petition earnings that were paid post-petition exempt under § 522(d)(10)(E), National's objection to exemption would be sustained because those earnings are clearly not based on the debtor's "right to receive . . . a payment under a stock bonus, pension, profitsharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service" However, the debtor listed the earnings as a "Commission payable monthly from Farmer's Insurance; 5% of paycheck to be received 4/1/08" on Schedule C and claimed an exemption under § 522(d)(5), not § 522(d)(10)(E). National did not object to the debtor's claim of exemption of the earnings under § 522(d)(5).¹

Contract Value

With regard to the termination pay or Contract Value portion of the Agreement [Contract Value], the debtor asserted on Schedule C of his petition that the Contract Value is not property of the estate, and claimed 100% of the Contract Value exempt under § 522(d)(10)(E). Under the terms of the Agreement, the debtor's right to receive the Contract Value is contingent upon cancellation or termination of the debtor's relationship with Farmers, subject to the exceptions listed above in the Background section. As

¹ National also argued that the monthly compensation was "most likely" based on policies that were sold pre-petition, or are premiums from re-insurance policies as discussed in cases cited in National's post-hearing brief. However, no evidence was presented to the Court in that regard.

previously discussed, the Court finds that the Agreement, which includes the Contract Value portion, is property of the estate. Because National objected to the debtor's claim of exemption under § 522(d)(10)(E), the Court must determine whether the Contract Value portion of the Agreement is based on the debtor's "right to receive . . . a payment under a stock bonus, pension, profitsharing, annuity, or similar plan or contract."

Under the terms of the statute, the debtor's right to receive payment under the Contract Value must meet three requirements to be exempted: (1) it must be from a "stock bonus, pension, profitsharing, annuity, or similar plan or contract"; (2) it must be "on account of illness, disability, death, age, or length of service"; and (3) it may be exempted only to the extent it is reasonably necessary to support the debtor or his dependents. 11 U.S.C. § 522(d)(10)(E); *see Rousey v. Jacoway*, 544 U.S. 320, 325-26 (2005). The party objecting to the claim of exemption has the burden of proving the exemption was not properly claimed. Fed. R. Bankr. P. 4003(c). The dispute in this case relates to the first and second requirements; the Court did not receive any evidence that, if allowed, the right to receive payment is not reasonably necessary for the support of the debtor or his dependents, and finds that the third requirement has been met.

According to the terms of the Agreement, Farmers shall pay the Contract Value "in the event of cancellation or other termination of the agency created," unless there is a right of immediate cancellation for any of the enumerated reasons set forth in the Agreement. The Agreement "shall terminate upon the death of the [debtor], and may be cancelled without cause by either the [debtor] or [Farmers] on 30 days written notice." The second requirement under the statute is written in the disjunctive; in other words, only one of the listed events must be satisfied for the requirement to be met. Because the second requirement under the statute includes the debtor's right to receive payment on account of death, and the Agreement includes such a provision, the Court finds that the second requirement has also been met in this case.

The first requirement is the most ambitious. The debtor argues that the Agreement

(specifically, the Contract Value) is a similar plan or contract in relation to a stock bonus, pension, profitsharing, or annuity plan or contract as required under § 522(d)(10)(E). The Court disagrees. After a detailed analysis of the characteristics of the plans and contracts listed in § 522(d)(10)(E), the Supreme Court determined that the common element of the listed plans is that they provide income that substitutes for wages. *Rousey*, 544 U.S. at 331. For the purpose of its analysis, the Court defined “wages” to mean “compensation earned as hourly or salary income.” *Id.* at 229. The Court then looked at specific provisions to determine whether the income the Petitioners will derive from their IRAs is income that would substitute for wages. Specifically, (1) an IRA requires the holder to withdraw funds by a certain age, “when they are likely to be retired and lack wage income,” (2) taxation of the money held in the IRA is deferred until it is distributed, thus encouraging “accountholders to wait until retirement to withdraw the funds,” (3) withdrawals before the account holder reaches age 59 1/2 are subject to a tax penalty, which restricts preretirement access to the funds, and (4) the account holder must take minimum distributions or be subject to a substantial tax penalty on funds improperly remaining in the account to make sure the IRA funds are used during retirement. *Id.* at 331-32.

The debtor in this case testified that he is an independent contractor or agent for Farmers, not an employee. As such, Farmers reports the income paid to the debtor on a tax form 1099 as a nominee distribution and does not withhold employment taxes. The income is subsequently reported on Schedule 1120S under the debtor’s company, Kershner Business Development Inc., Farmers Insurance District Office, which then pays the debtor a salary. Although the debtor has a right to establish an IRA or other retirement vehicle, there is no indication that the funds the debtor may receive under the Contract Value portion of his Agreement is that vehicle, even though the debtor intends to use that money during retirement. Paying the debtor as an independent contractor calls into question the use of the Contract Value as a substitute for compensation earned as hourly or salary income as required under *Rousey* because the debtor is not an employee and does not receive hourly or salary income.

Additionally, the considerations of the Supreme Court in relation to an IRA are instructive. First, in this instance there is no requirement that the debtor “withdraw” funds by a certain age when he is likely to be retired; the only requirement for distribution results from cancellation of the Agreement without cause by either party on written notice, or by the death of the debtor. Second, although any distribution presumably would be subject to taxation upon distribution, there is no guarantee that the money will ever be distributed or that the debtor will have access to the Contract Value. The right to receive payment under a stock bonus, pension, profitsharing, annuity, or similar plan or contract is an unequivocal right for the account holder or the holder’s heirs to receive payment. Those funds are the account holder’s funds. No such unequivocal right exists in this instance. In the event of certain “bad acts” or abandonment as enumerated in the Agreement, the Agreement is immediately cancelled and terminated and the debtor is not entitled to the Contract Value. In other words, the “retirement” account can simply vanish. Third, there is no restriction to “preretirement” access of the funds. If the debtor decides to give written notice tomorrow of his desire to cancel the Agreement, the debtor presumably will receive the current Contract Value without restriction (subject to the security interest Farmers has in the money the debtor previously borrowed against the Contract Value). Finally, there is no requirement to receive minimum distributions or be subject to a tax penalty before the debtor reaches a certain age to make sure the Contract Value is used during retirement. Payment of the Contract Value is based solely on a published schedule allowing between two and six equal semi-annual installments, depending on the length of service the debtor served as district manager.

For the above reasons, the Court finds that the Contract Value portion of the Agreement is not a “right to receive . . . a payment under a stock bonus, pension, profitsharing, annuity, or similar plan or contract,” and the debtor is not entitled to exempt the Contract Value under § 522(d)(10)(E). Accordingly, National’s objection to the debtor’s claim of exemption is sustained.

Conclusion

The Court finds that the Agreement is property of the estate. The debtor claimed the Agreement exempt under § 522(d)(10)(E) and National timely objected to the debtor's claim of exemption. Additionally, the debtor claimed the monthly compensation portion of the Agreement relating to pre-petition earnings paid post-petition exempt under § 522(d)(5). Because no party timely objected to the exemption claimed under § 522(d)(5), the pre-petition earnings paid post-petition are exempt under § 522(d)(5). 11 U.S.C. § 522(l).

The debtor also claimed the Contract Value of the Agreement exempt under § 522(d)(10)(E), to which National's objection also applies. For the reasons stated above, National's objection to the exemption is sustained. However, as stated above, the debtor's interest in the Contract Value is an inchoate interest, subject to the cancellation of the Agreement without cause by either party on written notice, or by the death of the debtor. Under certain enumerated conditions, the Agreement may be immediately cancelled and terminated and the debtor would not be entitled to the Contract Value. The debtor testified that as of the date of filing his petition, the value of the Contract Value was \$250,000.

The Court finds that the value of the Contract Value as of the date of filing is \$250,000 and is property of the estate, although contingent at the time of filing and not payable until such time as the debtor's appointment with Farmers is terminated or cancelled. The Court further finds that the debtor is not entitled to exempt the Contract Value under § 522(d)(10)(E). However, because the asset is an inchoate interest, the Court will preserve the asset as an unadministered asset of the estate. 11 U.S.C. § 554(d). In the event the asset is realized in the future, the case may be reopened to administer the asset. *Potter*, 228 B.R. at 423.

IT IS SO ORDERED.

November 6, 2008

DATE



BEN T. BARRY
UNITED STATES BANKRUPTCY JUDGE

cc: Chris Lisle, attorney for National Home Centers, Inc.
Jill Jacoway, attorney for the debtor
John T. Lee, chapter 7 trustee
United States Trustee

EOD 11/6/2008
by T Wilkins