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Summary of In re Christensen, 122 Nev. Adv. Op. No. 111

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In re Christensen, 122 Nev. Adv. Op. No. 111 (Dec. 28, 2006)[1]

BANKRUPTCY LAW – EARNING EXEMPTION

Summary

Pursuant to NRAP 5, the United States Bankruptcy Court for the District of Nevada certified five questions to the Nevada Supreme Court concerning the interpretation of NRS 21.090(1)(g), which provides for the exemption of a certain percentage of a debtor's disposable earnings.

Disposition/Outcome

The Nevada Supreme Court answered the five questions as requested.

Factual and Procedural History

The certified questions were initiated by three separate bankruptcy proceedings.

The Christensens:

Chad and Tina Christensen filed bankruptcy under Chapter 7, Title 11 of the United States Code on May 12, 2004. At that time, the trustee of the bankruptcy estate, Stan Pack, requested that the Christensens turn over $889.72 in funds they held in four separate bank accounts. Subsequently, the Christensens amended their Schedule C, asserting that 75 percent of these funds were exempt pursuant to Nevada's earning exemption statute, NRS 21.090(1)(g). Further, Mr. Christensen submitted an affidavit declaring that the sole source of the bank account funds was employment earnings.[2] However, Pack filed an objection asserting that the Christensens lost their exemption when the earnings were paid and the funds were deposited.

Shortly following a bankruptcy hearing on June 1, 2005, the Nevada Legislature signed Senate Bill 173 into law on June 6, 2005, thereby amending NRS 21.090(1)(g) to clarify that proceeds of exempt earnings retain the exemption upon deposit into the debtor's bank account. Thus, the parties filed briefs concerning the effect of these amendments on NRS 21.090(1)(g). Pack asserted that the amendment only applied to the deposit from the most recent pay period before filing. The Christensens argued that NRS 21.090(1)(g), as clarified by S.B. 173, allowed them to permanently retain 75 percent of the deposited funds.

Edmonson

On July 1, 2005, Sharon Edmonson filed a petition for voluntary bankruptcy, claiming a 75 percent exemption of her $1,050.00 bank account balance.[3] She claimed the sole source of

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[1] Summarized by Erin Phillips
[2] This included a $1,000 deposit on May 11, 2004.
[3] The parties later stipulated that Edmonson's balance upon filing was actually $1,322.62 due to outstanding transactions.

the bank account funds was earnings from her biweekly salary, which was directly deposited into her account.[4] The trustee to the bankruptcy estate, James Lisowski, subsequently filed an objection to the exemption, contending that NRS 21.090(1)(g) as amended only applied to earnings from the most recent week as opposed to any biweekly pay period.

Sokolowski

On July 1, 2005, Angela Sokolowski filed for voluntary bankruptcy. At that time, she claimed a 75 percent exemption of funds totaling $1,691.96, which she held in three separate bank accounts. The parties stipulated that the funds held in these accounts were directly traceable to semi-monthly direct deposits made by Sokolowski's employer. As appointed trustee, Lisowski filed an objection to the exemptions, asserting that NRS 21.090(1)(g) as amended only applied to earnings from the most recent week and not the semi-monthly pay period.

Pursuant to the issues presented in these cases, the bankruptcy court certified five questions to the Nevada Supreme Court. As a threshold question, the bankruptcy court asked whether NRS 21.090(1)(g), prior to its 2005 amendments, only protected unpaid earnings from partial garnishment, or instead, did it extend such exemptions to property that could be identified as direct proceeds of earnings. If the court extended the exemption to direct proceeds of earnings, four additional questions were posed: whether the exemption protected only proceeds of the most recent deposit or all deposits; how long the exemption continued and whether it extended to subsequent forms of proceeds; whether the commingling of proceeds in an account with nonexempt funds destroyed the exemption; and how Nevada law identified which portion of the account should be exempt.

Discussion

Nevada's wage garnishment exemption is rooted in the state constitution;[5] however, the state legislature enacted the first exemption statute in 1911. The apparent purpose of this initial statute was to protect a portion of the debtor's earnings to support himself and his family.[6] Later, the Nevada Legislature opted out of the federal exemption scheme and instead enacted NRS 21.090(1)(g), which provided that 75 percent of a judgment debtor's disposable earnings for any pay period were exempt from execution. In 2005, the legislature amended this statute through the enactment of Senate Bill 173,[7] which changed the term "pay period" to "workweek," exempted 75 percent of earnings for that week, and defined the term "earnings."[8]

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[4] However, statements from her account revealed deposits from an unidentified source and therefore, parties did not stipulate that the entire balance of the account was directly traceable to disposable earnings.

[5] "The privilege of the debtor to enjoy the necessary comforts of life shall be recognized by wholesome laws, exempting a reasonable amount of property from seizure or sale for payment of any debts…" Nev. Const. art. 1, § 14.

[6] *See* In re Galvez, 990 P.2d 187, 188 (Nev. 1999).

[7] The amended statute is only applicable to the Edmonson and Sokolowski matters because the Christensens filed prior to the enactment of S.B. 173.

[8] "'Earnings' means compensation paid or payable for personal services performed by a judgment debtor in the regular course of business, including, without limitation, compensation designated as income, wages, tips, a salary, a commission or a bonus. The term includes compensation received by a judgment debtor that is in the possession of the judgment debtor, compensation held in accounts maintained in a bank or any other financial institution or, in the case of a receivable, compensation that is due the judgment debtor." 2005 Nev. Stat., ch. 290, § 5, at 1015.

Question 1

The first question addressed by the court was whether the pre-amended NRS 21.090(1)(g) extended to property that could be identified as direct proceeds of earnings. In response, the court rejected the claims of the trustees that the earnings lost exemption protection once they were deposited into the debtor's bank account. The court analogized the issue to its decision in *Security National Bank v. McColl*,[9] where it held that veteran's benefits did not lose exempt status under federal law when deposited into a bank account.[10] There, the court relied on the United States Supreme Court decision in *Porter v. Aetna Casualty Co.*,[11] which held that Congress intended to permit veterans to protect their benefits through normal modes of safekeeping, provided that the benefits were not converted into permanent investments. Accordingly, the benefits did not lose exempt status once deposited into an interest-bearing account with a federal savings and loan association.[12] The court further stated that similar rationale has been employed by other state courts. For example, the Iowa Supreme Court has noted that the logistics of modern-day living often require an individual to first deposit his earnings into a bank account before he can spend these funds.[13]

Moreover, the court noted that Nevada bankruptcy courts have held that proceeds of earnings retain their exempt status when deposited into a bank account either by the debtor's employer or the debtor himself. As explained by the bankruptcy court in the case of *In re Norris*,[14] despite NRS 21.090(1)(g)'s silence on the issue, the historical purpose of the exemption statute was to ensure that the debtor could retain basic life necessities for himself and his family. Thus, the Norris court held that a deposit of earnings by the debtor's employer should not affect their exempt status provided that they are directly traceable to such earnings.[15] Similarly, in *In re Shuey*,[16] the court extended the exemption to cover deposits by an employer into a "Savings Plan." These payments accumulated over a thirteen-month period and were then paid to the employee in a lump sum.[17] Nevertheless, the bankruptcy court held that the funds retained in the account were direct proceeds of exempt property and therefore also exempt.[18]

Finally, the court reasoned that the 2005 statutory amendments further supported a legislative intent to extend exempt status to earnings deposited into a bank account. By specifically including compensation held in bank accounts in its definition of "earnings," the court determined that the impetus behind S.B. 173 was to clarify the legislature's original intent in enacting NRS 21.090(1)(g).[19] As such, the court concluded that the pre-amended NRS 21.090(1)(g) created a garnishment exemption for 75 percent of earnings that extended to property that was considered direct proceeds of such earnings.

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[9] 385 P.2d 825 (Nev. 1963).
[10] *Id.* at 826.
[11] 370 U.S. 159 (1962).
[12] *Id.*
[13] MidAmerica Sav. Bank v. Miehe, 438 N.W.2d 837, 839 (Iowa 1989).
[14] 203 B.R. 463, 467-68 (Bankr. D. Nev. 1996).
[15] *Id.*
[16] No. 03-52753, 2005 Bank. LEXIS 1011 (Bankr. D. Nev. June 8, 2005).
[17] *Id.* at *1-3.
[18] *Id.*
[19] The court explained that "[w]here a former statute is amended, or a doubtful interpretation of a former statute rendered certain by subsequent legislation, it has been held that such amendment is persuasive evidence of what the Legislature intended by the first statute." In re Christensen, 122 Nev. Adv. Op. No. 111 (Dec. 28, 2006) (quoting Sheriff v. Smith, 542 P.2d 440, 443 (Nev. 1975).

Question 2

Next, the court addressed whether NRS 21.090(1)(g), both pre- and post-amendments, only applies to the most recent deposit, a portion of the deposit, or all deposits. Prior to the 2005 amendments, the statutory language exempted 75 percent of the disposable earnings during *any* pay period. Pursuant to the enactment of S.B. 173, the word "pay period" was substituted with the word "week."[20] However, it retained the modifier "any," therefore denouncing the trustees' claim that the exemption is limited only to deposits from a particular pay period or workweek. Thus, in light of the court's policy of construing statutes liberally in favor of the debtor, it held that any and all deposits of earnings are exempt.

Question 3

The third question the court addressed was how long the exemption continues and whether it extends to other forms of proceeds. The court primarily relies on the fact that NRS 21.090(1)(g) and relevant case law remain silent on the issue of how long an asset may remain exempt, unlike the codes and case law of other states. Thus, the court took this silence to indicate a legislative intent not to impose temporal limitations on exemptions. Furthermore, the court again looks at the Supreme Court case of *Porter v. Aetna Casualty Co.*,[21] which posed a similar issue. There, the Supreme Court concluded that veteran's benefits deposited into a bank account retained their exempt status provided that they "remained subject to demand and use as the needs of the veteran support and maintenance required."[22] The benefits lost their exemption once they were transformed into permanent investments and no longer retained the quality of money.[23] Based on this analysis, the court determined that the NRS 21.090(1)(g) exemptions extend indefinitely as long as they can be traced by a recognized accounting method.[24]

However, as to the second portion of the question, the court refused to extend the exemption to subsequent forms of proceeds. The court explained that NRS 21.090(1) specifically provided for any additional exemptions and therefore, it was without power to extend the reach of the statute. Furthermore, NRS 21.090(1)(g) only protects traceable proceeds; therefore, property is not exempt merely because it was purchased with proceeds from the exempt earnings. Moreover, the legislative purpose of providing funding for ordinary living costs is undermined if these proceeds are converted into permanent investments. As such, the court held that subsequent forms of proceeds are not exempt.

Question 4

Next, the court considered whether the commingling of proceeds from exempt earnings with non-exempt funds destroys their exempt status. The court noted that NRS 21.090(1)(g) is silent on the issue of commingling, unlike other exemption statutes. For example, NRS

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[20] The court explained that the amendment was clearly intended to reverse its decision in *In re Galvez*, where it held that NRS 21.090(1)(g) only applied to earnings that were "periodic" in nature and therefore the statute did not exempt the debtor's real estate commission that was in escrow at the initiation of bankruptcy proceedings. 115 Nev. 417, 990 P.2d 187 (1999).

[21] 370 U.S. 159 (1962).

[22] *Id.* at 161.

[23] *Id.*

[24] These accounting methods are discussed in response to question five.

612.710(2) provides an exemption for unemployment compensation benefits as long as they are not commingled with other funds. Pursuant to basic principles of statutory construction,[25] the court concluded that the omission of this restriction in NRS 21.090(1)(g) was intentional. Moreover, the court noted that the significant majority of courts only strip commingled funds of exempt status when tracing is not possible. In line with the majority view, the court held that proceeds of earnings remained exempt despite commingling with non-exempt funds provided tracing was still possible.

Question 5

Lastly, the court addressed how Nevada law would trace the proceeds of exempt earnings. The court rejects the debtors' suggestion of a case-by-case approach in favor of a single method of tracing to circumvent an increase in litigation. Because NRS 21.090(1)(g) is silent in regard to tracing methods, the court looked to four general approaches. The first approach was the lowest intermediate balance rule (LIBR), which requires that the exempt fund never exceed the lowest balance during the time between the deposit of the exempt amount and the time of the levy.[26] However, the court declined this method because it is more relevant to conversion actions and not particularly useful for wage exemption statute. The second approach was the pro-rata method, which attributes withdrawals to exempt and non-exempt funds based on their respective proportions within the account. However, the court rejected this approach because it failed to sufficiently protect the rights of creditors. The third approach was the last-in, first-out (LIFO) approach, which assumes that the last funds deposited into the account are the first funds used. The court also declined this method as a less workable approach. Accordingly, the court settled on the first-in, first-out (FIFO) method, which assumes that the first funds deposited into an account are the first funds paid out. The court reasoned that this approach ensured that debtors can meet the expense of life necessities while at the same time recognizing the rights of creditors.

Conclusion

The court addressed and resolved each of the five certified questions posed by the United States Bankruptcy Court for the District of Nevada. As a threshold matter, the court concluded that NRS 21.090(1)(g), in its original and amended versions, applies to the proceeds of earnings deposited into a debtor's bank account. These exemptions apply to all deposits and are not limited to the most recent pay period or workweek. Additionally, deposited earnings remain exempt indefinitely provided they are traceable and not converted into subsequent forms of proceeds. Further, these earnings retain exempt status despite being commingled with non-exempt funds as long as tracing is possible. Finally, the court adopted the first-in, first-out (FIFO) approach for tracing exempt funds within commingled accounts.

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[25] The court relies on the principle that the omission of a qualifier within a statute is presumed intentional if the qualifier is included in another similar statute.

[26] Even though new deposits might be exempt funds, they will not replenish the initial exempt fund.