

**IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE SOUTHERN DISTRICT OF IOWA**

In the Matter of:

Neal Burdette Bottger,

Case No. 14-01165-als7

Debtors.

Chapter 7

**MEMORANDUM OF DECISION  
(date entered on docket: April 15, 2015)**

COURSE OF PROCEEDINGS

Before the Court are the Trustee's Notice of Intent to Sell Property pursuant to 363(b), the Trustee's Objection to the Debtor's claim of exemption and objections thereto, which were heard at telephonic hearing. Wesley Huisinga, the chapter 7 trustee, appeared on behalf of the estate. The debtor was represented by Edward Noyes. Paula Roby was present on behalf of Eric Beane, an interested party. Jurisdiction for these matters is found at 28 U.S.C. sections 157(b)(1) and 1334. Upon review of the docket, the filed documents and the arguments presented, the following findings and conclusions of law are entered pursuant to Federal Rules of Bankruptcy Procedure 7052 and 9014.

FACTS

Prior to filing bankruptcy, Bottger took out a loan against his homestead to purchase a house, located at 201 Swan in West Burlington, Iowa ("Swan Property"), for his daughter to live in. She decided not to remain. Bottger then sold the Swan Property, which he owned free and clear, to William M. Bowers on contract.

Eric Benne (Attorney 1) filed a voluntary chapter 7 bankruptcy petition on behalf of Bottger on May 7, 2014. Schedule A of that filing disclosed that Bottger owned interests in three parcels of real estate. His homestead at 414 Broadway, West Burlington, Iowa was valued at \$62,500 with an existing mortgage in the amount of \$54,319. This asset was claimed as exempt on Schedule C in its full value. The Swan Property was valued at \$49,700. Real estate located at 415 South Leebrick, Burlington, Iowa, valued at \$46,400 with a mortgage against it in the amount of \$40,319.07 was disclosed as being sold on contract to Damon J. Dreckmeier and Cara I. Brounacker (“Leebrick Property”).

On June 2, 2014 the chapter 7 trustee filed a Motion to Compromise and Settle Bottger’s interest in the real estate being sold on contract to Bowers for the amount of \$25,000.<sup>1</sup> No timely objection was filed to this action and an order approving the transaction was entered on June 27, 2014. U.S. Bank filed a motion for relief from stay to proceed with foreclosure on Bottger’s homestead<sup>2</sup> which was granted by order entered on July 23, 2014. On June 24, 2014 Attorney 1 withdrew as Bottger’s counsel.

On October 17, 2014 Edward Noyes (Attorney 2) filed amended Schedules A, B and C on behalf of Bottger. Amended Schedule A did not include the Leebrick Property that was identified in the initial filing. Amended Schedule B added a legal malpractice claim against Attorney 1 valued at \$35,000 which was claimed as exempt on the Amended Schedule C under Iowa Code section 627.6(16) (2014) as a personal injury claim. The trustee objected to the exemption claim which Bottger contested. The trustee agreed to sell the cause of action to

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<sup>1</sup> Upon review of the filed documents, it appears that the Debtor’s schedule A references the incorrect legal descriptions for this parcel of real estate. The contract for sale of the Swan Property includes the legal description of Lot 1, in Block Number 7, in the City of West Burlington, Des Moines County, Iowa (docket number 13).

<sup>2</sup> Upon review of the filed documents, it appears that the Debtor’s schedule A references the incorrect legal descriptions for this parcel of real estate. The homestead located at 414 Broadway is legally described on U.S. Bank’s mortgage as The Whole of Lot No. 9, in Block No.8, in THIRD ADDITION to CITY of WEST BURLINGTON, Des Moines County, Iowa. (docket number 17).

Bottger, but informed Attorney 2 that he could not proceed with the sale until the contested exemption issue was resolved. Attorney 2 withdrew the debtor's objection and an order sustaining the objection to exemption in the legal malpractice claim was entered on December 2, 2014. The trustee filed a notice of his intent to sell the legal malpractice claim to Bottger. Attorney 1 objected and offered a higher amount. No other timely objections were filed. A hearing on this contested matter was scheduled. Prior to the hearing, the trustee filed a motion seeking authority to sell the cause of action at auction which was granted.

On February 8, 2014 Attorney 2 filed an objection to the higher bid. On February 10, 2014 second amendments to Schedules B and C were filed on behalf of the debtor. This most recent Amended Schedule B identified a "Personal Injury from Legal Malpractice Claim" valued at \$60,000. This asset was claimed as exempt under Iowa Code section 627.6(16) as a "Personal Injury Claim." The trustee objected to this amended exemption claim. At the hearing the trustee argued that the exemption of the legal malpractice claim was subject to a final order which prevented Bottger from arguing an identical exemption claim and that a legal malpractice claim is not a personal injury claim that is exempt under Iowa law. Attorney 2 argued that it is inequitable to the debtor to allow Attorney 1 to bid on the asset and that the equities of this situation lie with Bottger. After allowing the parties additional time to submit further written arguments or exhibits, the matter was placed under advisement.

#### DISCUSSION

The first issue to be resolved is the parties' dispute involving Bottger's second amendment to Schedule C claiming the legal malpractice claim as exempt. The trustee asserts that the Court's December 2, 2014 order sustaining his objection to exemption in the legal malpractice is res judicata on this issue. Under Federal Rule of Bankruptcy Procedure 1009(a)

Debtors are given a right to amend their schedules “as a matter of course at any time before the case is closed.” According to this Rule Bottger’s amendment to Schedule C is permitted. Whether res judicata applies under the circumstances of this case must be evaluated separately.

Bottger had the following options to resolve the trustee’s objection to the exemption claim made to his first amended Schedule C: litigate the contested claim of exemption or resolve the trustee’s pending objection to exemption or concede that the cause of action was not exempt. Based upon the undisputed facts, Bottger sought to resolve the issue and attempted to retain the legal malpractice claim by purchasing his non-exempt interest from the trustee. In his effort to achieve this goal he withdrew his pending objection.<sup>3</sup> As a result of this withdrawal, an order was entered holding that the legal malpractice claim was not exempt.

The theories raised by the trustee have been routinely applied to disputed exemption claims. See Ladd v. Ries, 450 F.3d 751 (8th Cir. 2006); Bryan v. Stanton, 466 B.R. 460 (B.A.P. 8th Cir. 2012); In re Gress, 517 B.R. 543 (Bankr. M.D. Pa. 2014). Res judicata, also known as claim preclusion, bars the relitigation of all claims and defenses if the matter has been definitively settled by a prior proceeding. “Res judicata prevents litigation of all grounds for, or defenses to, recovery that were previously available to the parties, regardless of whether they were asserted or determined in the prior proceeding.” Johnos Inc. v. Ziadeh (In re Ziadeh), 276 B.R. 614, 618 (Bankr. N.D. Iowa 2002). Claim preclusion requires a final judgment on the merits. The Eighth Circuit has explained its application as follows:

The binding effect of a former adjudication, often generically termed res judicata, can take one of two forms. Claim preclusion (traditionally termed res judicata or "merger and bar") bars relitigation of the same claim between parties or their privies where a final judgment has been rendered upon the merits by a

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<sup>3</sup> The sale of the legal malpractice claim did not ultimately occur due to the objection filed by Attorney 1. Attorney 2 argued at hearing that he was unaware that Attorney 1 would have the ability to bid on the claim lodged against him and that to allow such conduct is unfair to his client under the circumstances.

court of competent jurisdiction. Issue preclusion (or "collateral estoppel") applies to legal or factual issues actually and necessarily determined, with such a determination becoming conclusive in subsequent suits based on a different cause of action involving a party to the prior litigation.

W.A. Lang Co. v. Anderberg-Lund Printing Co. (In re Anderberg-Lund Printing Co.), 109 F.3d 1343, 1346 (8th Cir. 1997) (citations omitted).

Res judicata bars the re-litigation of all claims and defenses if the matter has been definitively settled by a prior proceeding. Claim preclusion requires a final judgment on the merits. To be successful in asserting res judicata the trustee must establish the following elements: "(1) the first suit resulted in a final judgment on the merits; (2) the first suit was based on proper jurisdiction; (3) both suits involved the same cause of action; and (4) both suits involved the same parties or their privies." In re Anderberg-Lund Printing Co., 109 F.3d at 1346 (8th Cir. 1997) (citations omitted). Additionally, "the party against whom res judicata is asserted must have had a full and fair opportunity to litigate the matter in the proceeding that is to be given preclusive effect. In re Ziadeh, 276 B.R. at 618.

Collateral estoppel (also known as issue preclusion) is a narrower doctrine than res judicata. "[W]hereas res judicata forecloses all that which might have been litigated previously, collateral estoppel treats only those questions actually and necessarily decided in a prior suit." 9D Am Jr. 2d Bankruptcy § 3717 (2015). A bankruptcy court can properly give "collateral estoppel effect to those elements of the claim that are identical to the elements . . . which were actually litigated and determined in the prior action." Grogan v. Garner, 498 U.S. 279, 284 (1991) (citing Restatement (Second) of Judgments § 27 (1982)).

An objection to a claim of exemption is a contested matter that requires findings of fact. In re Cogliano, 355 B.R 792, 801 (B.A.P. 9th Cir. 2006). It is clear that Bottger only withdrew

his objection in an effort to resolve the objection to his exemption claim with the trustee. Absent additional facts the Court cannot conclude that such an action served as a concession that the cause of action was not exempt. Even if Bottger's position on his right to his claimed exemption may not have ultimately been successful, he was not afforded any opportunity to argue his position because he believed he had reached a resolution of the issue with the trustee. According to the posture of this case, *res judicata* (issue preclusion) and claim preclusion cannot be appropriately applied to the Court's order entered on December 2, 2014 because entry of that order did not arise from a contested exemption issue that was actually considered by the Court.

The second issue to be decided is the parties' current dispute related to the trustee's objection to the exemption of the legal malpractice cause of action as a personal injury claim. At the commencement of a bankruptcy case an estate is created that includes all legal and equitable property interests held by a debtor, which includes causes of action. 11 U.S.C. § 541 (2014); *U.S. v. Whiting Pools, Inc.*, 462 U.S. 198, 205 n. 9 (1983). Debtors may claim applicable exemptions under either federal or state law to retain property of the estate which places it beyond the reach of creditors or the trustee. *Addison v. Seaver (In re Addison)*, 540 F.3d 805, 809 (8th Cir. 2008). As permitted by 11 U.S.C. section 522(b) Iowa has opted out of the federal exemption scheme. See Iowa Code § 627.10 (2014). A resident of Iowa filing bankruptcy is limited to the exemptions provided for under state law. Iowa Code section 627.6(16) allows an exemption in:

The debtor's interest in payments reasonably necessary for the support of the debtor or the debtor's dependents to or for the benefit of the debtor or the debtor's dependents, including structured settlements, resulting from personal injury to the debtor or the debtor's dependents or the wrongful death of a decedent upon which the debtor or the debtor's dependents were dependent.

The trustee argues that the legal malpractice cause of action is outside the scope of the state exemption statute. See Venard v. Winter, 524 N.W.2d 163, 165 (Iowa 1994) (holding that cause of action arising from an attorney's failure to properly prepare a contract was not a personal injury); Barrett v. Burt, 250 F.Supp. 904 (S.D. Iowa 1966) (holding that the statute of limitations for a legal malpractice claim is not the same as that for a personal injury).

Bottger argues that he has claims for the negligent infliction of emotional distress which are separate and distinct from the legal malpractice claim. This reasoning is unpersuasive. Bottger concedes that the cause of action at issue in the exemption dispute arises from conduct involving Attorney 1 prior to his bankruptcy filing. Although emotional distress may constitute a component of the damages that may be awarded, the basis of the claim remains the same under a theory of legal malpractice. Bottger does not deny that his cause of action arises from negligence due to the legal malpractice he alleges occurred. This fact cannot be changed by revising the description of the cause of action on Schedule C. Because the legal malpractice claim does not qualify as a personal injury under Iowa law it cannot be claimed as exempt under 11 U.S.C. section 627.6(16).

Bottger also asserts that the equities favor an application of 11 U.S.C. section 105(a) which permits the Court to "issue any order, process, or judgment, that is necessary or appropriate to carry out the provisions of this title." The broad authority conferred under this code provision specifically references the Court's inherent ability to insure compliance with the bankruptcy code. However, a court's authority to take action is limited and cannot be utilized to create a private right of action, result in an action that is contrary to the bankruptcy code, or serve to expand rights that are not provided for by statute. See Law v. Siegel, 134 S.Ct. 1188, 1194 (2014); In re Nosek, 544 F.3d 34, 43 (1st Cir. 2008). Bottger's request for relief pursuant to 11

U.S.C. section 105(a) would result in court action contrary to the exemption provisions found at 11 U.S.C. section 522 and under Iowa law. Consequently, exercise of the Court's authority under 11 U.S.C. section 105(a) is not appropriate in this case.

The final matter before the Court involves the trustee's ability to sell the non-exempt asset represented by the legal malpractice claim. A trustee is charged with liquidating estate property for the benefit of creditors. It would seem intuitive that a non-exempt asset is subject to administration in a chapter 7 bankruptcy case. However, such a conclusion is not absolute. "Property interests are created and defined by state law," and in the bankruptcy laws "Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law." Butner v. United States, 440 U.S. 48, 54–55 (1979). "Unless some federal interest dictates otherwise, state law determines a debtor's property interests in bankruptcy." Holstein v. Knopfler (In re Holstein), 321 B.R. 229, 234 (Bankr. N.D. Ill. 2005) (quoting Barnhill v. Johnson, 503 U.S. 393, 398 (1992)). Just as the exemption claimed by Bottger is subject to state law, so is a determination of whether a cause of action has accrued prior to filing in order for it to constitute property of the estate. In this case, no party has raised the issue of whether the legal malpractice claim was fully accrued on the date of filing, so the Court will not reach a determination of this issue.<sup>4</sup> The objection to the Trustee's Notice of Sale is overruled. The trustee is authorized to sell whatever interest the bankruptcy estate holds in the legal malpractice claim at the time the case commenced.

For the reasons stated it is ORDERED:

1. The Debtor's objection to the trustee's objection to the second amended claim of exemption in the legal malpractice claim as a personal injury is overruled.

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<sup>4</sup> Timmerman v. Eich, 809 F.Supp.2d 932 (N.D. Iowa 2011); Vossoughi v. Polaschek, 859 N.W. 2d 643 (Iowa 2015); Collins v. Federal Land Bank of Omaha, 421 N.W.2d 136 (Iowa 1988).

2. The trustee's objection to the Debtor's second amended claim of exemption in the legal malpractice claim as a personal injury claim is sustained.

3. The trustee is authorized to sell whatever interest the estate has in the legal malpractice claim as of the petition date.

/s/ Anita L. Shodeen  
Anita L. Shodeen  
U.S. Bankruptcy Judge

Parties receiving this Memorandum of Decision from the Clerk of Court:  
Electronic Filers in this Chapter Case