In the United States Bankruptcy Court

for the Northern District of Iowa

Western Division

CHARLES A. JAMES and SANDRA K. JAMES — Bankruptcy No. 93-51413XS
Debtors. — Chapter 7

ORDER RE: MOTION TO COMPROMISE OBJECTION TO EXEMPTION

The matter before the court is a motion by the case trustee to compromise his dispute with the debtors over the debtors' claim of two homestead exemptions. Donald H. Molstad filed his motion to compromise on December 3, 1993, and gave notice of it to all creditors. None has objected. Hearing on the motion was held February 15, 1994. Molstad appeared pro se. Wil L. Forker appeared for Charles and Sandra James, the debtors.

The facts are not disputed. Debtors formerly lived in South Dakota. On December 4, 1991, they entered into a contract to sell their homestead to Sam and Carlotta Westphal. The purchase price was $25,000.00. The Westphals were to pay $1,975.00 at the time of the execution of the contract and monthly payments of $150.00 beginning on December 1, 1992, until the contract was paid in full. Interest on the unpaid balance was to be calculated at the rate of five per cent per annum, payable monthly. Jameses moved to Chatsworth, Iowa, where they purchased a home. When debtors filed their chapter 7 petition on August 19, 1993, they claimed their home in Chatsworth as exempt under Iowa Code 561.2 and 561.16. They estimated the home had a value of $10,000.00. According to the schedules, it is unencumbered by any debt.

Debtors amended their claims of exemption to claim also the real estate contract for the sale of their home in South Dakota. The latter is claimed exempt under South Dakota Codified Laws (S.D.C.L.) 43-45-3(2). That section provides in part:

In the event such homestead is sold . . . by the owner voluntarily, the proceeds of such sale, not exceeding the sum of thirty thousand dollars, is absolutely exempt for a period of one year after the receipt of such proceeds by the owner.

According to South Dakota law, "absolute exemptions" may apply to non-residents. S.D.C.L 43-45-7(1). "Absolute exemptions" are not subject to conditions or qualifications. Longley v. Daly, 1 S.D. 257, 46 N.W. 247, 249 (1890).

Debtors have resisted the trustee's objection contending that the "proceeds" of the homestead that remain exempt for one year are the buyers' monthly payments of $150.00 still due at the time of filing. The trustee contends that the proceeds of the homestead was the contract-for-deed, which was received by debtors more than one year prior to their filing bankruptcy. The parties desire to settle the dispute by the debtors paying the estate $150.00 per month for 12 months.

In determining whether to approve a compromise, the court must consider (1) the probability of success in the litigation; (2) the difficulties to be encountered in collection; (3) the complexity of the case and the expense of litigation; and (4) the interests of creditors, giving deference to their views. See In re Flight Transportation Corporation Securities Litigation, 730 F.2d 1128, 1135 (8th Cir. 1984) cert. denied by Reavis & McGrath v. Antinore, 105 S.Ct. 1169 (1985). In shorthand form, it is said that the settlement should not fall below the lowest point in the range of reasonableness. In re W. T. Grant Co., 699 F.2d 599, 608 (2nd Cir.) cert. denied by Cosoff v. Rodman, 104 S.Ct. 89 (1983).

The compromise before the court presents no substantial issue as to three of the tests. The litigation is not complex although the issue presented is somewhat difficult; the costs of litigation would not be substantial as no facts are

disputed. There is no indication or argument that, if successful, the trustee could not collect the funds. No creditor has objected. However, the court has an independent obligation to consider whether the settlement is reasonable or in the best interest of the estate.

It is the uncertain outcome of the litigation which prompts the trustee to propose the settlement. Neither party can find any case on point. Each side can make a reasonable argument for its desired outcome. There are no South Dakota cases on point. On the one hand, exemption laws are to be construed favorably for the debtors. But on the other, an interpretation of the statute favoring the debtors would in effect yield the debtors two homestead exemptions in a situation where the proceeds of one of them are clearly not being used to fund the purchase of the homestead where debtors now reside. The Minnesota Supreme Court has pointed out the unfairness of such a situation in a similar case, but it has noted that correction of the problem is one for the legislature. O'Brien v. Johnson, 275 Minn. 305, 148 N.W.2d 357, 361 (1967).

The proposal of this settlement creates problems which do not normally arise when fact issues exist. Here, according to the attorneys, there are no factual disputes. They are uncertain of the outcome because they do not know how the court will construe the statute. The court must consider the possible and likely constructions in determining whether the settlement is reasonable. It would be unfair to determine or to rule on the merits as the parties are not trying the case. It would be premature for the court to issue its final ruling on the construction of the statute and its effect on the uncontested facts. The court need only consider whether a decision maker could reasonably rule in favor of either party, and it could.

Without deciding the controversy, the court determines that the proposed settlement is not reasonable. Despite the mandate to construe exemption statutes in favor of the debtors, the trustee is not without persuasive arguments. Moreover, the parties have failed to discuss or perhaps to consider the statutory requirement that the court must base its ruling on the state law applicable "at the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of filing of the petition. . . ." 11 U.S.C. 522(b)(2)(A). Nor have the parties cited any "choice of law" rules or statutes which would require the court to apply South Dakota law to this case.

Last, the court takes notice that the unsecured debt listed by the debtors in their schedules totals approximately $18,000.00. The proposed settlement, after deduction for trustee's fees and expenses, would yield them only about $1,400.00, less than eight cents on the dollar if all file claims. More than 20 per cent of the settlement would go to administrative costs.

Having considered the foregoing factors, the court declines to approve the settlement. The court realizes that after trial and a full and complete analysis and consideration of the issues, it may be put in the position of denying the trustee's objection, despite the fact that it has not approved the trustee's present proposal. Be that as it may,

IT IS ORDERED that the trustee's motion to compromise the objection to the debtors' claim of exemption in the Westphal real estate contract is DENIED.

SO ORDERED ON THIS 22nd DAY OF FEBRUARY, 1994.

William L. Edmonds
Chief Bankruptcy Judge

I certify that on _____ I mailed a copy of this order by U. S. mail to: Donald H. Molstad, Wil Forker and U. S. Trustee.