2002 BNH 016 **Note: This is an unreported opinion. Refer to AO 1050-1 regarding citation.**

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW HAMPSHIRE

In re: Bk. No. 00-10486-JMD
Chapter 7

Patricia A. Donovan,
Debtor

Patricia Donovan
Pro Se Debtor

Michael Askenaizer, Esq.
Chapter 7 Trustee

John Sherman, Esq.
Attorney for the Town of Greenfield and
Gary Gagnon

MEMORANDUM OPINION

I. INTRODUCTION

On April 3, 2002, the Court held a hearing on a Motion to Approve Settlement Agreement (Town of Greenfield and Police Chief Gary Gagnon) and Release of Claims[1] (the "Settlement Motion") filed by the Chapter 7 Trustee, Michael Askenaizer (the "Trustee") and on a Motion to Amend Schedule C (the "Motion to Amend") filed by the Debtor, Patricia Donovan (the "Debtor"). After hearing from all parties the Court took the matter under submission.

This Court has jurisdiction of the subject matter and the parties pursuant to 28 U.S.C. §§ 1334 and 157(a) and the "Standing Order of Referral of Title 11 Proceedings to the United States

[1] The Court notes that the April 3rd hearing on the Settlement Motion was a continued hearing. The Court had previously held a hearing on the Settlement Motion on January 23, 2002. This memorandum opinion will only address the form of the settlement that was presented at the April 3, 2002 hearing.

Bankruptcy Court for the District of New Hampshire," dated January 18, 1994 (DiClerico, C.J.). This is a core proceeding in accordance with 28 U.S.C. § 157(b).

II. FACTS

A. Background

On February 25, 2000, the Debtor filed a Chapter 7 bankruptcy petition with this Court. On April 14, 2000, the Trustee conducted an examination of the Debtor while she was under oath pursuant to 11 U.S.C. § 341 (hereinafter the "341 Meeting"). At the 341 Meeting the Trustee asked the Debtor if she had listed all of her assets on her schedules and she answered affirmatively. The Debtor did not mention anything about a potential harassment lawsuit that the Debtor had against the Town of Greenfield (the "Town") and Gary Gagnon ("Gagnon"). On April 14, 2000 the Trustee filed a report of no assets. On June 7, 2000 the Debtor received her discharge and on June 15, 2000 the above captioned case was closed.

B. Settlement

1. History

The Trustee testified that in March of 2001 he was contacted by an Attorney Aivalikles. Attorney Aivalikles represented the Debtor in a lawsuit that was then pending before the United States District Court for the District of New Hampshire (the "District Court"). Through Attorney Aivalikles, the Trustee learned that the claim the Debtor was pursuing in the District Court was a pre-petition claim she held against the Town and Gagnon. The Trustee testified that because the claim had not been listed on the Debtor's bankruptcy schedules he contacted the Debtor's

bankruptcy counsel Mark Wolterbeek ("Wolterbeek") and informed Wolterbeek that the Debtor's case needed to be reopened for the purpose of amending the Debtor's schedules.

On April 9, 2001 the Debtor filed a motion to reopen her bankruptcy case to amend schedule B. On April 10, 2001 the Court granted the Debtor's request to reopen her bankruptcy case and amend schedule B. Accordingly, schedule B of the Debtor's bankruptcy petition was amended to list the Debtor's lawsuit against the Town and Gagnon. See Doc. No. 13.

2. Asset Administration

The Trustee testified that since the Debtor had not claimed an exemption in the lawsuit he took steps to administer the asset. The Trustee first contacted Attorney Aivalikles to see if he would take the case on a contingency basis for the estate. When Attorney Aivalikles declined to take the case the Trustee began negotiating a settlement with the Town and Gagnon (collectively the "Defendants"). The Trustee testified that he spent months negotiating a settlement with the Defendants. The Trustee further testified that while he was negotiating a settlement he was contacted by the Debtor once or twice and he informed the Debtor that he was attempting to settle the matter with the Defendants.

On December 12, 2001, the Trustee filed the Settlement Motion with the Court seeking to settle with both the Town and Gagnon. At the April 3, 2002 hearing the Trustee presented the Court with the terms of a revised settlement agreement (the "Settlement Agreement").[2] The Trustee represented to the Court that the dollar amount of the settlement had not changed since the last hearing on the Settlement Motion held in January of 2002. Further, the Settlement Agreement still contained a provision requiring that none of the settlement proceeds be distributed to the Debtor.

[2] Only those settlement terms relevant to the Court's decision on the Settlement Motion will be discussed in this memorandum opinion.

In order to ensure that the Debtor did not receive any of the settlement proceeds new language had been added to the Settlement Agreement. The new language provided for the unlikely event that settlement proceeds remained after payment of the Trustee's fees and the claims of creditors. Upon the happening of the aforementioned event, the Settlement Agreement required the excess funds to be returned to the Defendants.

The Debtor objected to the Settlement Agreement. The Debtor stated that she did not want the settlement to go through as she wanted to get her case back into the District Court. Further, the Debtor did not think it was fair that any "excess funds" would be returned to the Defendants.

C. Amendments to Schedules

1. Background/Amendment to Schedule B

At the April 3, 2002, hearing the Debtor admitted that her signed original schedules had failed to list the potential lawsuit against the Defendants. However, the Debtor testified that she met with Wolterbeek at least three times prior to the filing of her bankruptcy petition. The Debtor testified that she had told Wolterbeek about the lawsuit at each of those three meetings. The Debtor further testified that she did not read the schedules before signing them as she assumed her attorney knew what he was doing.

The Debtor testified that she did not intentionally leave the lawsuit off her schedules. She testified that she did not think of the lawsuit as an asset and never connected the lawsuit and her bankruptcy filing in her mind. Further, the Debtor testified that she had told Attorney Aivalikles about her bankruptcy filing. Specifically, the Debtor testified that at the time the lawsuit against the Defendants was filed in District Court Attorney Aivalikles knew about her bankruptcy filing, but did not say anything to the Debtor about the lawsuit being an asset of the estate.

2. Amendment to Schedule C

On January 9, 2002, the Debtor filed a motion to use her wild card exemption. The motion was denied by the Court on the ground that the motion was not the proper manner to claim an exemption. See Doc. No. 21. On January 15, 2002, the Debtor filed the Motion to Amend. In her Motion to Amend the Debtor sought permission to amend schedule C of her bankruptcy petition to claim an exemption in the above mention lawsuit against the Defendants.

The Debtor testified that it was her intent to obtain justice in the District Court. At the April 3, 2002, hearing the Debtor specifically represented to the Court that she did not want the settlement to go through as she wanted to pursue her claim in the District Court. She further represented to the Court that her delay in filing the Motion to Amend Schedule C was due to the fact that it took her a long time to go through the books at the library since she is representing herself in this matter.

III. DISCUSSION

A. Motion to Amend Schedule C

Rule 1009(a) allows a debtor to amend his or her schedules as a matter of course any time prior to the case being closed. Case law, however, has established two clear exceptions to a debtor's right to amend his or her schedules, prejudice and bad faith. See e.g., Osborn v. Durant Bank & Trust Co., 24 F.3d 1199, 1206 (10th Cir. 1994); In re Yonikus, 996 F.2d 866, 872 (7th Cir. 1993); Stinson v. Williamson (In re Williamson), 804 F.2d 1355, 1358 (5th Cir. 1986); Arnold v. Gill (In re Arnold), 252 B.R. 778, 784 (B.A.P. 9th Cir. 2000); Pope v. Clark (In re Clark), 274 B.R. 127, 136 (Bankr. W.D. Pa. 2002).

The Trustee argued at the April 3rd hearing that the Motion to Amend should be denied because it was done in bad faith and he would suffer prejudice if the amendment were allowed. The Trustee pointed out that months had passed by the time he filed a motion to approve the settlement and nine months had passed before the Debtor attempted to claim an exemption in the lawsuit. The Debtor argued that she was not trying to frustrate anyone and was simply attempting to get her lawsuit against the Defendants back to the District Court where it belonged.

1. Bad Faith

> "[B]ad faith generally requires concealment of an asset or an exemption of which the creditors have no knowledge and thus no opportunity to investigate. It requires something more than a mistaken failure to list an asset or to claim an exemption. In sum, to have 'bad faith,' there must be some form of deception."

McFatter v. Cage, 204 B.R. 503, 508 (S.D. Tex. 1996). Fraudulent concealment of an asset can be evidence of a debtor's bad faith and can serve as a proper ground for denying an exemption in the asset. See Yonikus, 996 F.2d at 873-74 (denying an exemption after finding that the Debtor fraudulently concealed an asset in bad faith where he did not list the lawsuit on his original schedules, hired separate bankruptcy and trial counsel, did not tell his bankruptcy counsel about the lawsuit, and did not tell his trial counsel about his bankruptcy filing).

The Debtor testified that she had not intentionally left the lawsuit off of her bankruptcy schedules. The Debtor also testified that she had told Wolterbeek about the lawsuit prior to his preparation of her schedules for filing with the Court. Finally, the Debtor testified that Attorney Aivalikles knew about her bankruptcy filing at the time the lawsuit was filed in the District Court. The Debtor's testimony demonstrates a clear attempt on her part to obtain a public vindication of wrongs she perceives were done to her by the Defendants. The Trustee offered no evidence to contradict the Debtor's testimony.

Based upon evidence presented at the hearing, the Court cannot find that the Debtor attempted to intentionally conceal the lawsuit from her creditors or the Trustee. Although the lawsuit was not listed on the Debtor's original bankruptcy schedules the Court finds that the omission was simply a mistake and not an attempt to conceal an asset. Accordingly, the Court finds that the Debtor's failure to list the asset on her schedules is not grounds for denying her Motion to Amend to claim an exemption in the lawsuit.

However, the evidence at the hearing established that the Debtor was aware of the omission of the law suit from her schedules sometime before the motion to reopen her case and amend Schedule B was filed on April 9, 2001. Further, the evidence demonstrates that she was in contact with the Trustee during the six to eight month period when he was attempting to administer the asset. The Debtor did not attempt to amend her claim of exemptions until after the Trustee filed his motion to approve the settlement. In support of her objection to approval of the Settlement Agreement the Debtor candidly stated that she did not want the settlement to "go through" because she wanted her case back in District Court. The Court finds that the Debtor's motivation in not seeking to claim an exemption in the lawsuit proceeds until the last moment was to prevent settlement of the suit on terms which were unacceptable to her. In effect she wanted to watch and see what the Trustee might accomplish and when the results were not to her liking to seek to impose a veto over those efforts. The Debtor presented no evidence that she ever mentioned to anyone that she might seek to claim an exemption in the lawsuit and did not claim such an exemption until it became strategically necessary for her to do so. Concealment of her claim of exemption in the aforementioned manner is the essence of bad faith. Accordingly, the Debtor's Motion to Amend shall be denied as being filed in bad faith.

2. Prejudice

Case law has established that the prejudice necessary to deny an amendment to a debtor's schedules need not be to the bankruptcy estate or to the creditor body as a whole. See e.g., Osborn, 24 F.3d at 1206; In re Blaise, 116 B.R. 398, 400-01 (Bankr. D. Vt. 1990). Prejudice to the trustee or a single creditor will suffice. Id. However, the fact that creditors will receive a lower distribution if a debtor's amendment is allowed does not constitute sufficient prejudice to deny a debtor the right to amend his or her schedules. McFatter, 204 B.R. at 508. "Prejudice involves creditors (and presumably the Trustee on their behalf) adopting a litigation position to their detriment in reliance upon conduct of the debtor." Id.

The testimony at trial revealed that the Debtor had contacted the Trustee during the time when the Trustee was negotiating a settlement with the Defendants. The Trustee further stated to the Court that the Debtor knew that if she were to receive any of the proceeds of the settlement the settlement would not go forward. Lastly, the Trustee represented to the Court that had an exemption been claimed in the lawsuit he would have filed a report of no assets and would not have spent months negotiating a settlement with the Defendants.

The Debtor stated to the Court that she did not want the parties to settle as she wanted her lawsuit to go back to the District Court where it belonged. The Debtor further represented to the Court that it had taken her a long time to go through books at the library regrading bankruptcy and that this was the reason for the delay in claiming the exemption.

Based upon the above testimony the court finds that if the Debtor's Motion to Amend were allowed the Trustee would be prejudiced. The Trustee took a litigation position based upon the fact that the Debtor had not claimed an exemption in the lawsuit. He spent months negotiating a

settlement with the Defendant's, an action he would not otherwise have taken had an exemption in the lawsuit been claimed. Further, the Debtor knew the Trustee was working on a settlement with the Defendants and knew that a condition of the settlement was that she receive none of the settlement proceeds. Yet, despite this knowledge the Debtor waited until January of 2002 to attempt to claim an exemption in the lawsuit. The Debtor knew that settlement negotiations were taking place. Such knowledge should have prompted a diligent effort on the part of the Debtor to determine her rights under the Bankruptcy Code. Accordingly, the Debtor's Motion to Amend could also be denied on the grounds of prejudice to the Trustee whose efforts and actions over eight months were known to the Debtor. In the absence of denial of the Motion to Amend for bad faith the Court would schedule a hearing on the value of the time and the expenses incurred by the Trustee and would require the Debtor to pay an amount determined by the Court as a condition of refiling a motion to amend. However, since the Motion to Amend has been denied on the grounds of bad faith, the Court need not quantify the prejudice to the Trustee.

B. Settlement Motion

The Bankruptcy Code provides a scheme for distributing property of a Chapter 7 bankruptcy estate in section[3] 726. 11 U.S.C. § 726. Under section 726(a)(6) any property remaining after the payment of creditors is to be returned to the debtor. Id. Approval of the Settlement Agreement would require the Court to approve distribution of property of the estate in contravention of the section 726 distribution scheme. This Court does not have the power to alter the section 726 distribution scheme in contravention of the Bankruptcy Code. See United States v. Yellin (In re Weinstein), 272 F.3d 39, 46 (1st Cir. 2001) (a court cannot impose its views over

[3] Unless otherwise indicated all references to "section" refer to Title 11 of the United States Code.

those of the legislature); Patriot Portfolio, LLC v. Weinstein (In re Weinstein), 164 F.3d 677, 682-83 (1st Cir. 1999) (state law may not interfere with the distribution scheme of the Bankruptcy Code); Thinking Machs. Corp. v. Mellon Fin. Servs. Corp. #1 (In re Thinking Machs. Corp.), 67 F.3d 1021, 1028 (1st Cir. 1995) (discussing the limits of a court's powers under 11 U.S.C. § 105).

The Settlement Motion for which the Trustee seeks approval calls for the Defendants to pay the bankruptcy estate a sum certain in settlement of claims held by the Debtor against the Defendants. Once the Defendants pay the settlement proceeds to the estate the proceeds then become assets of the estate to be distributed by the Trustee in accordance with section 726. See 11 U.S.C. § 541. However, the Settlement Agreement contains a provision requiring the Trustee to return to the Defendants any settlement proceeds that remain after the payment of the Trustee's fees and payments to creditors. Such a provision is contrary to the distribution scheme contained in section 726. As noted above, this Court has no power to alter the distribution scheme set forth in section 726. Accordingly, the Court must deny approval of the Settlement Motion.

IV. ORDER

For the reasons stated above the Court shall enter separate orders denying the Motion to Amend and the Settlement Motion**.** This opinion constitutes the Court's findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052.

DATED this 15th day of May, 2002, at Manchester, New Hampshire.

/s/ J. Michael Deasy
J. Michael Deasy
Bankruptcy Judge