

**UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION**

In re:

Case No. 3:10-bk-2735-PMG

RICHARD BALLOU, III,

Debtor.

Chapter 7

**ORDER ON (1) DEBTOR'S OBJECTION TO TRUSTEE'S NOTICE OF INTENT TO
COMPROMISE OR SETTLE CLAIM OF THE ESTATE, AND (2) TRUSTEE'S OBJECTION
TO DEBTOR'S AMENDED CLAIM OF EXEMPTIONS**

THIS CASE came before the Court for a final evidentiary hearing to consider (1) the Debtor's Objection to Trustee's Notice of Intent to Compromise or Settle Claim of the Estate, and (2) the Trustee's Objection to Debtor's Amended Claim of Exemptions.

The Trustee entered into a compromise to resolve a foreclosure action involving the Debtor's non-exempt residential property (the Residence), as well as a prepetition counterclaim filed by the Debtor in the foreclosure action (the Counterclaim). After the proposed compromise was filed with the Court, the Debtor amended his schedules to claim the Residence as exempt.

The Court finds that the Debtor's amended claim of exemption should be disallowed because it is prejudicial to creditors. The Residence and Counterclaim are property of the estate subject to the

Trustee's administration, and the Trustee's compromise should be approved as a proper exercise of his business judgment.

Background

On March 31, 2010, the Debtor filed a petition under Chapter 7 of the Bankruptcy Code.

On his schedule of assets, the Debtor listed a Residence located in Jacksonville, Florida, with a value of \$256,083.00. The Residence was fully encumbered by a mortgage in the scheduled amount of \$351,285.62. On his schedule of assets, the Debtor also listed various bank accounts, household goods, and personal effects with a total value of \$4,338.15, and a "counterclaim against Saxon Mortgage for violation of Federal and Florida law" with an "unknown value."

On his schedule of exemptions, the Debtor claimed the bank accounts, household goods, and personal effects as exempt pursuant to Article X, §4(a)(2) of the Florida Constitution and the "wildcard" exemption provided by §222.25(4) of the Florida Statutes. The total value of the exemptions claimed under the Florida Constitution and §222.25(4) was \$4,338.15.

The Debtor did not claim the Residence or Counterclaim as exempt. On his Statement of Intention filed with the petition and schedules, the Debtor indicated that the Residence was not claimed as exempt and that he intended to surrender the property.

On May 20, 2010, the §341 meeting of creditors was concluded in the case.

On June 8, 2010, the Trustee submitted his "notice of recovery of assets" to the Court.

On April 5, 2011, the Trustee filed a Notice of Intent to Compromise or Settle Claim of the Estate. (Doc. 21). In the Notice, the Trustee asserted that the holder of the mortgage on the Residence had filed a foreclosure action against the Debtor, that the Debtor had filed a Counterclaim against the

mortgage holder, that the Counterclaim was property of the estate, and that the Trustee had compromised the Counterclaim against the mortgage holder. According to the Trustee, the compromise involved a payment to the estate in an amount sufficient to make a 30% distribution to the holders of allowed unsecured claims in the Chapter 7 case. In exchange for the payment, the Trustee agreed to the entry of a judgment in the mortgage holder's favor in the foreclosure action.

On April 25, 2011, the Debtor filed an Objection to the Trustee's Notice of Intent to Compromise. (Doc. 24). In the Objection, the Debtor asserted that he was willing to pay more to the estate than the amount that the Trustee would receive under the Trustee's proposed settlement with the mortgage holder.

A preliminary hearing on the Debtor's Objection to Compromise was scheduled for June 15, 2011.

On June 13, 2011, two days before the scheduled hearing, the Debtor filed an amended schedule of property claimed as exempt. (Doc. 27). On the amended schedule, the Debtor claimed the Residence as exempt homestead property under the Florida Constitution. The "Counterclaim against Saxon Mortgage" also appears on the amended schedule with an exempt value of "0.00" pursuant to Article X, §4(a)(2) of the Florida Constitution. Additionally, the Debtor claimed a portion of his bank accounts and household goods as exempt, to the extent of \$1,000.00 in value, pursuant to Article X, §4(a)(2) of the Florida Constitution. Since the Debtor was claiming a homestead exemption under the Florida Constitution, he did not claim the "wildcard" exemption for the balance of his household goods and personal effects.

On June 15, 2011, the Trustee filed an Objection to the Debtor's Amended Claim of Exemptions. (Doc. 28). In the Objection, the Trustee asserts that he had detrimentally relied on the Debtor's original

exemptions by undertaking “significant efforts to liquidate and negotiate a settlement with the secured creditor” on the Residence. The Trustee also asserts that the Debtor has used and depleted the personal property that he initially claimed as exempt pursuant to the wildcard exemption. Consequently, the Trustee contends that the Debtor should not be permitted to amend his claim of exemptions to add the Residence at this stage in the administration of the case.

Discussion

A final evidentiary hearing was conducted on the Debtor’s Objection to the Trustee’s Notice of Intent to Compromise, and on the Trustee’s Objection to the Debtor’s Amended Claim of Exemptions.

Based on the record presented at the final evidentiary hearing, the Court finds that the Debtor’s amended claim of exemptions should be disallowed, because allowance of the amendment would be prejudicial to creditors. The Debtor did not claim the Residence and Counterclaim as exempt on his original schedules, and the Trustee administered the Residence and Counterclaim as property of the estate during the fourteen-month period prior to the filing of the amended schedules.

Second, the Court finds that the Trustee’s proposed compromise should be approved. The proposed compromise constitutes a proper exercise of the Trustee’s business judgment, and the Debtor lacks standing to object to the terms of the settlement.

A. The Debtor’s Amended Claim of Exemptions

The Debtor’s amended claim of exemptions should be disallowed, because allowance of the amendment would be prejudicial to creditors.

Rule 1009(a) of the Federal Rules of Bankruptcy Procedure provides that a debtor’s schedules “may be amended by the debtor as a matter of course at any time before the case is closed.”

F.R.Bankr.P. 1009(a). Courts have described Rule 1009(a) as the “permissive approach” to the amendment of schedules. In re Martias, 2008 WL 906776, at 2 (Bankr. S.D. Fla.).

In the Eleventh Circuit, it is generally recognized that “the bankruptcy court may deny a debtor the right to amend his or her schedules, including the schedule of exempt assets, only ‘on a showing of a debtor’s bad faith or of prejudice to creditors.’” In re Allen, 2011 WL 2493065, at 3 (Bankr. S.D. Fla.)(quoting In re Doan, 672 F.2d 831, at 833 (11th Cir. 1982)). The “Eleventh Circuit’s precedent in *Doan*, gives the Court discretion to ‘deny leave to amend on a showing of a debtor’s bad faith or of prejudice to creditors.’” In re Wilson, 446 B.R. 555, 562 (Bankr. M.D. Fla. 2011).

For purposes of denying a debtor’s amended schedule of exemptions, “prejudice to creditors” has been found where the debtor delayed the filing of his amended schedules while the Trustee pursued the turnover of property that had not initially been claimed as exempt. In that circumstance, the delayed amendment created additional administrative expenses that reduced the amount that was ultimately available for distribution to creditors. In re Wilson, 446 B.R. at 562.

In determining whether to deny an amendment to schedules on the basis of prejudice, the focus is on the effect of allowing the amendment upon creditors and other parties in interest. . . . [P]rejudice may be established by showing harm to the litigating posture of parties in interest. If the parties would have taken different actions or asserted different positions had the exemption been claimed earlier, and the interests of those parties are detrimentally affected by the timing of the amendment, then the prejudice is sufficient to deny amendment. Moreover, an amendment is prejudicial if it impairs a trustee in the diligent administration of the estate.

In re Talmo, 185 B.R. 637, 645 (Bankr. S.D.Fla. 1995)(Emphasis supplied). In Talmo, the debtor claimed a homestead exemption for the first time approximately eighteen months after the bankruptcy petition was filed. The Court found that the amended claim was prejudicial to the estate, because the trustee had devoted time and resources to market the previously non-exempt property, and because he

had not pursued other business strategies that might otherwise have been considered. In re Talmo, 185 B.R. at 647. Consequently, the amended schedule of exemptions was stricken, and the newly-claimed exemptions were not allowed.

In this case, the Debtor filed his initial schedules with his bankruptcy petition on March 31, 2010. At that time, he did not claim his Residence as exempt homestead property, and instead claimed certain personal property as exempt pursuant to the “wildcard” exemption provided by §222.25(4) of the Florida Statutes. The “wildcard” exemption provides a debtor who does not claim or receive the benefits of a homestead exemption with a personal property exemption that is in addition to the amount provided by the Florida Constitution. Fla. Stat. §222.25(4).

More than fourteen months after the petition date, on June 13, 2011, the Debtor amended his schedules to claim the Residence as exempt homestead, and to eliminate the personal property exemptions claimed under the wildcard provision. During the intervening fourteen months, the Debtor had possessed and used the previously non-exempt personal property as his own. (See Transcript, pp. 26-30).

Additionally, during the fourteen months between the petition date and the amendment, a number of events occurred in the progress of the case: (1) the §341 meeting of creditors was commenced, continued to allow for further examination of the Debtor, and concluded on May 20, 2010; (2) the Trustee submitted his notice of recovery of assets on June 8, 2010; (3) the bar date for filing proofs of claims was established on June 9, 2010, and expired on September 13, 2010; and (4) the holder of the mortgage on the Residence filed a Motion for Relief from the Automatic Stay and obtained the entry of an Order modifying the stay on June 9, 2010. (Docs. 9, 13).

Perhaps even more significantly, during the fourteen-month period before the amended schedules were filed, the Trustee engaged in extensive efforts to resolve the Counterclaim and the foreclosure action on the Residence. Neither the Residence nor the Counterclaim were claimed as exempt at the time that the efforts were undertaken, and the Debtor acknowledges that the Counterclaim is property of the bankruptcy estate. (Transcript, p. 53).

At the final evidentiary hearing, the Trustee testified in detail regarding the actions that he took to administer the Counterclaim and foreclosure action involving the Residence. Specifically, the Trustee testified that he personally reviewed the state court files, that it was difficult to locate a representative of the mortgage company with authority to negotiate, and that an issue arose regarding whether the Debtor's former wife claimed an interest in the Residence. As a result of the Trustee's efforts, however, he ultimately negotiated an integrated settlement of both the Counterclaim and the estate's interest in the Residence. (Transcript, pp. 19-21, 34, 36-38).

Pursuant to the proposed settlement with the mortgage holder, the estate was to receive an amount sufficient to make a 30% distribution to the holders of allowed claims in the Chapter 7 case. The Debtor objected to the proposed Compromise, and a hearing was scheduled to consider the Objection. The Debtor's amended schedules were filed two days before the scheduled hearing.

Under these circumstances, the Court finds that the Debtor's amended claim of exemptions is prejudicial to creditors and should be disallowed. In reliance on the Debtor's original schedules, the Trustee incurred substantial expense to administer non-exempt assets of the estate, and to obtain a meaningful recovery for creditors. For fourteen months, while the expenses were incurred, the Debtor did not seek to amend his schedules. If his amended exemptions were allowed at this stage of the case,

the administrative expenses incurred by the Trustee would reduce the funds that are otherwise available to pay creditors. The timing of the amendment, and the reduction of the funds available for distribution, is prejudicial to creditors within the meaning of the Eleventh Circuit's decision in Doan. In re Wilson, 446 B.R. at 562; In re Talmo, 185 B.R. at 645-47.

B. The Trustee's Notice of Intent to Compromise

Second, the Court finds that the Trustee's compromise of the foreclosure litigation should be approved, because it represents a proper exercise of the Trustee's business judgment.

It is generally recognized that trustees possess the discretion to compromise claims and settle disputes. In re Shingleton, 2007 WL 2743503, at 4 (Bankr. D. Idaho)(quoting In re Rake, 363 B.R. 146, 151-52 (Bankr. D. Idaho 2007)). The duty of a trustee is to collect the assets of the estate and to settle its accounts "on whatever grounds he, in his informed discretion, believes will net the maximum return for the creditors (on whose behalf he toils)." In re Mailman Steam Carpet Cleaning Corp., 212 F.3d 632, 634 (1st Cir. 2000)(quoted in In re Beaulac, 294 B.R. 815, 819 (1st Cir. BAP 2003)).

In evaluating a compromise reached by a trustee, "the court's role is to ensure that the trustee has exercised proper business judgment in making the decision to agree to the proposed settlement." In re Arkoosh Produce, Inc., 03.3 I.B.C.R. 149, 153 (Bankr. D. Idaho 2003)(quoted in In re Shingleton, 2007 WL 2743503, at 5.). To fulfill its role, the Court neither "rubber stamps" the trustee's settlement nor substitutes its judgment for the trustee's, but instead determines whether the settlement falls "below the lowest point in the range of reasonableness." In re Diplomat Construction, Inc., 2011 WL 3269325, at 2 (N.D. Ga.)(quoting In re W.T. Grant Co., 699 F.2d 599, 608 (2d Cir. 1983)).

In In re Dennett, 449 B.R. 139, 148 (Bankr. D. Utah 2011), for example, the Court found that the Chapter 7 trustee had appropriately exercised his discretion and business judgment by compromising a number of prepetition claims that had been asserted by the debtor. Similarly, in In re McDonald, 430 B.R. 5, 12 (Bankr. D. Maine 2010), the Court determined that the trustee's decision to compromise certain claims was a proper exercise of his business judgment. In both cases, the Court determined that the trustee's settlements were within the range of reasonableness and approved the compromises.

In this case, the Compromise involved an action to foreclose a mortgage on the Debtor's non-exempt Residence, together with a Counterclaim that had been asserted by the Debtor in the foreclosure action. The Debtor's schedules indicate that the Residence was fully encumbered, and that the asset held no equity for the estate. The Counterclaim was described only as a claim for "violation of Federal and Florida law," and was scheduled as having an "unknown" value. It includes multiple Counts and a demand for jury trial. (Trustee's Exhibit 2).

The Trustee's Notice of Intent to Compromise the foreclosure action and Counterclaim states that the "settlement proceeds will provide a dividend of approximately 30% to timely filed unsecured claims, after administrative fees and expenses." (Doc. 21, ¶ 4). The settlement proceeds will constitute property of the estate and be distributed pursuant to §726 of the Bankruptcy Code.

In his Objection to the compromise, the Debtor asserts only that the "amount that is to be paid to creditors is less than the amount the debtor is willing to pay. The creditors could receive a greater distribution if debtor settled with the estate." (Doc. 24). The Objection should be overruled.

First, a Chapter 7 debtor generally lacks standing to object to the trustee's compromise involving property of the estate. "Since title to property of the estate no longer resides in the chapter 7 debtor, the

debtor typically lacks any pecuniary interest in the chapter 7 trustee's disposition of that property.” Spenlinhauer v. O'Donnell, 261 F.3d 113, 118 (1st Cir. 2001)(quoted in In re McDonald, 430 B.R. 5, 9 (Bankr. D. Me 2010)). Unless the estate's assets will generate a surplus, the debtor's interests are not affected by the compromise. In re McDonald, 430 B.R. at 9. See also In re Smithey, 2011 WL 3102308, at 8 (Bankr. N.D. Ohio)(On “matters concerning the compromise of claims, a Chapter 7 debtor has no ‘dog in the fight.’”).

In this case, the Debtor does not object to the Compromise in his capacity as a creditor of the estate, or on the basis that he will be entitled to surplus funds after distribution to creditors. On the contrary, the Debtor's only objection is that he is willing to pay the Trustee an amount greater than the amount received pursuant to the settlement. The Debtor lacks standing to object to the compromise on the basis that he tendered an unsuccessful offer. See In re Squire, 2008 WL 2497706, at 3 (6th Cir.)(“Frustrated bidders do not have standing to object to the sale of property.”).

Second, the Trustee considered the Debtor's offer and concluded that it was not as beneficial to the estate as the settlement with the mortgage holder. Specifically, the Debtor offered the Trustee the sum of \$4,000.00 in cash, plus a portion of the recovery in the event that the Debtor prevailed on the Counterclaim. (Transcript, p. 30). The cash component of the offer was less than the amount of the cash to be received under the proposed settlement with the mortgage holder, and the balance of the offer was contingent on the outcome of the litigation. On this basis, the Trustee determined that the Debtor's offer was not equivalent to the mortgage holder's offer. (Transcript, p. 31).

Under these circumstances, the Court finds that the Trustee's proposed Compromise with the mortgage holder was reasonable and represents a proper exercise of the Trustee's business judgment.

In reaching the settlement, the Trustee resolved litigation that was of questionable value to the estate, without the cost and delay of further adversary proceedings, and obtained settlement funds in an amount sufficient to make a meaningful distribution to creditors of the estate.

The Debtor's Objection to the Compromise should be overruled, and the Trustee's Compromise should be approved.

Conclusion

This matter is before the Court on the Debtor's Objection to the Trustee's Notice of Intent to Compromise, and the Trustee's Objection to the Debtor's Amended Claim of Exemptions.

The Debtor's Amended Claim of Exemptions should be disallowed, because allowance of the amendment would be prejudicial to creditors. Additionally, the Trustee's Compromise of the foreclosure action and Counterclaim should be approved as a proper exercise of the Trustee's reasonable business judgment. Accordingly:

IT IS ORDERED that:

1. The Debtor's Objection to Trustee's Notice of Intent to Compromise or Settle Claim of the Estate is overruled, and the compromise proposed by the Chapter 7 Trustee is approved.
2. The Trustee's Objection to Debtor's Amended Claim of Exemptions is sustained, and the Debtor's Amended Claim of Exemptions is disallowed.

DATED this 13 day of September, 2011

BY THE COURT

Paul M. Glenn

PAUL M. GLENN
Chief Bankruptcy Judge