UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
GREENSBORO DIVISION

IN RE:	)	
	)	
Mack L. Scott,	)	Case No. 00-10993C-7G
	)	
Debtor.	)	

MEMORANDUM OPINION

This case came before the court on April 9, 2002, for hearing upon the Trustee's motion to compel the Debtor to turnover proceeds and for hearing upon the Trustee's objection to amended exemptions, which matters were taken under advisement. This case came before the court again on May 7, 2002, for hearing upon the Debtor's motion to amend an order that was entered in this case on November 7, 2000. Charles M. Ivey, III and Joshua N. Levy appeared on behalf of the Trustee and G. Keith Whited appeared on behalf of the Debtor. Having considered the evidence offered by the parties and the arguments of counsel, the court makes the following findings of fact and conclusions of law pursuant to Rules 7052 and 9014 of the Federal Rules of Bankruptcy Procedure with respect to all three matters.

FACTS

When this Chapter 7 case was filed on April 25, 2000, the Debtor was a party to two civil actions that were pending in Maryland in the Circuit Court of Montgomery County. In the earlier of the two actions the Debtor was a defendant in a suit brought by his former employer, Attronica Computers, Inc.("Attronica"). In

the second suit, which was filed only two months before this bankruptcy case was filed, the Debtor was the plaintiff in a suit against Attronica and two individual defendants. The suit filed by Attronica, in which the Debtor was a defendant, was disclosed in the statement of financial affairs filed in this case by the Debtor. However, the suit in which the Debtor was plaintiff ("the State Court Action") was not disclosed anywhere in the schedules or statement of financial affairs filed by Debtor in this case. However, on August 8, 2000, Debtor filed a motion for relief from stay, identifying the State Court Action and requesting that "the automatic stay provisions of 11 U.S.C., Sec. 362, be modified and lifted as to the civil action in Montgomery Count in File No. 207499, Mack L. Scott v. Attronica Computers, Inc., Atul Thakkar, Niel Thakkar so that the Plaintiff can proceed to enforce its rights and claims against the Defendants as permitted by Maryland Law." A copy of the complaint in the State Court Action was attached to the motion. The clerk's office issued and served a tentative hearing notice upon the Debtor, Debtor's attorneys, the Trustee, the Bankruptcy Administrator and the attorney for the defendants in the State Court Action. The notice set August 26, 2000, as the last day for objecting to the motion and stated that if no objections were filed, the court would consider the motion without a hearing and that if objections were filed, a hearing would be held on September 6, 2000. When no objections to the

motion were filed, counsel for Debtor submitted an order granting the motion which was signed and entered on October 3, 2000.

After receiving a copy of the motion for relief from stay, the Trustee talked with counsel for the Debtor regarding the State Court Action and was told that Debtor's suit was in the nature of a counterclaim to offset the claims that had been asserted against the Debtor in the suit filed by Attronica and had minimal value. The Trustee thereafter had little, if any, discussion regarding the State Court Action prior to April of 2001. However, on April 19, 2001, the Trustee received a letter from the attorney representing the defendants in the State Court Action in which the attorney suggested that the Trustee become involved in the suit so that he could "garner" for the bankruptcy estate any proceeds from the suit. Following the receipt of this letter the Trustee began to communicate with counsel for the defendants as well as the attorney representing the Debtor in the State Court Action. In these communications the Trustee made it known that he regarded the claims in the State Court Action as property of the bankruptcy estate and that any proceeds from the suit should be paid to the Trustee and administered in the bankruptcy case. These communications included letters to Debtor's counsel in Maryland in which the Trustee asserted that the claims in the State Court Action were property of the bankruptcy estate and that the Trustee had succeeded to the Debtor's interest in the State Court Action.

Debtor's counsel disagreed with the Trustee's claim. The Trustee then wrote to Debtor's counsel on February 8, 2002, asserting that the dispute regarding his interest in the State Court Action should be resolved in the bankruptcy court and requested that no action be taken which would waive any rights or settle the matter until the bankruptcy court had determined the proper parties to litigate or negotiate a settlement in the State Court Action. Despite the requests of the Trustee, the Debtor proceeded to settle the State Court Action in February, 2002, pursuant to a settlement in which the Debtor, through his counsel in Maryland, was paid the sum of $90,000.00. This occurred without notice to or participation by the Trustee and without his consent or approval and also without notice to creditors or approval by the bankruptcy court. In his motion, the Trustee seeks to compel the Debtor to turnover these funds to the Trustee as property of the estate in this case.

DISCUSSION

1. The Claims in the State Court Action Constituted Property of the Estate.

The State Court Action was pending when this bankruptcy case was filed. Hence, it is clear that all of the claims alleged in the State Court Action arose out of events that occurred prior to the filing of the petition in this case. Since the claims arose pre-petition, the claims became property of the estate pursuant to § 541 of the Bankruptcy Code when this case was filed. See United States v. Whiting Pools, Inc., 462 U.S. 198, 205 n.9, 103 S.Ct.

2309, 2313 n. 9, 76 L.Ed.2d 515 (1983); In re Swift, 129 F.3d 792, 795 (5th Cir. 1997); In re Clark, 274 B.R. 127, 132 (Bankr. W.D. Pa. 2002); Neville v. Harris, 192 B.R. 825, 830 (D.N.J. 1996); In re Davis, 158 B.R. 1000, 1002 (Bankr. N.D. Ind. 1993); 5 COLLIER ON BANKRUPTCY ¶ 541.08 (15th ed. rev. 2002).

2. There Was No Abandonment of the Claims Involved in the State Court Action.

Despite the claims having become property of the estate initially, the Debtor argues that the claims were not property of the estate in February of 2002 when the State Court Action was settled because they were abandoned from the estate. Debtor first argues that such abandonment occurred when an order was entered on October 3, 2000, granting his motion for relief from stay to proceed with the State Court Action. This argument is not accepted. The granting of relief from the automatic stay pursuant to § 362(d) of the Bankruptcy Code is separate and distinct from abandonment of property of the estate which is controlled by § 554 of the Bankruptcy Code. When a bankruptcy court lifts the automatic stay, it merely removes the injunction prohibiting collection actions against the debtor or the debtor's property. Although this may result in property of the estate passing from the control of the estate, it does not mean that estate's interest in the property is extinguished. See Catalano v. Commissioner of Internal Revenue, 279 F.3d 682, 686 (9th Cir. 2002); In re Saylors, 869 F.2d 1434, 1437 (11th Cir. 1989). "Termination of the

automatic stay is neither analogous to, nor the equivalent of, an abandonment of property of the estate." In re Ridgemont Apartment Assocs., 105 B.R. 738, 741 (Bankr. N.D. Ga. 1989). In accord In re Angel, 142 B.R. 194, 198 (Bankr. S.D. Ohio 1992) ("Relief from stay did not effectuate an abandonment. . . . In a bankruptcy context, only abandonment constitutes a waiver of a trustee's interest.").

As pointed out in the Catalano case, "abandonment" is a term of art with special meaning in the bankruptcy context. It is the formal relinquishment of the property at issue that can occur only in the manner prescribed in § 554. See Catalano, 279 F.3d at 685-86. Where, as in the present case, closing of the case has not occurred, abandonment of estate property may occur only as provided in subsections (a) and (b) of § 554. Under § 554(a), after notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate. Under § 554(b), on request of a party in interest and after notice and a hearing, the court may order the trustee to abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate. Debtor's motion for relief in this case does not fall within either of these provisions. Subsection (a) clearly is not applicable since the motion was filed by the Debtor and not the Trustee. Subsection (b) is not applicable for several reasons. First, and most obvious, the motion filed by the Debtor

did not request, or even mention, abandonment of the Attronica claims. This is a critical point because if the Debtor had requested abandonment, then the specific issue of whether the claims were burdensome to the estate or of inconsequential value and benefit to the estate would have been raised and addressed by the court. Secondly, and as a result of the content of Debtor's motion, creditors and other parties in interest were not provided with the kind of notice and hearing required under § 554(b), i.e., notice that abandonment of an asset of the estate was being sought and a hearing in which that issue could be addressed. Without such notice and hearing, abandonment of an asset of the estate is not permitted under § 554(a) or (b). See In re Ellwanger, 140 B.R. 891, 902 (Bankr. W.D. Wash. 1992).

Debtor also argues that the order modifying the stay which was entered on October 3, 2000, by its terms, provided for an abandonment of the claims alleged in the State Court Action. This argument apparently is based upon the language in the order that provides that "the Debtor herein may proceed in that state court action to enforce its rights and claims against the Defendants as permitted by Maryland law." (Emphasis supplied). This argument also is rejected. It is possible that an order modifying the automatic stay could also provide for an abandonment. However, in order for this to occur, the order must explicitly refer to abandonment and the notice and hearing requirements of § 554 must

be met. See Catalano, 279 F.3d at 687 ("However, if an abandonment order is included within an order issued pursuant to another section of the Bankruptcy Code, the order must set forth the abandonment specifically and affirmatively, and parties in interest must have received the requisite notice and hearing required by § 554(a)."). The order in the present case, containing no reference to abandonment, obviously does not meet these requirements and hence did not provide for an abandonment of the claims in the State Court Action.

The Debtor next argues that in discussions regarding a motion for approval of a settlement with his former wife, the Trustee, in effect, agreed to an abandonment of the claims alleged in the State Court Action. As the party asserting abandonment, the Debtor has the burden of showing by the greater weight of the evidence that abandonment has occurred. See Neville v. Harris, 192 B.R. at 830 ("The party seeking to prove abandonment under Section 554 has the burden of persuasion."). The evidence offered by the Debtor was insufficient to show by a preponderance any concessions, agreements or other basis for finding that the Trustee was agreeing that the bankruptcy estate would have no further interest in the claims asserted in the State Court Action or that the Trustee was agreeing to an abandonment of such claims. Moreover, any such agreement by the Trustee, without specific notice to creditors and a hearing pursuant to § 554, would be ineffective. See Sierra Switchboard

Co. v. Westinghouse Elec. Corp., 789 F.2d 705, 710 (9th Cir. 1986)(rejecting a claim that Chapter 7 trustee entered into a binding contract to abandon a claim, stating that "[e]ven if the trustee intended abandonment by signing the 1982 stipulation, the agreement would be of no effect without prior notice to creditors."). See also In re Clark, 274 B.R. at 133-34 (failure of Chapter 7 trustee to join in a pending suit involving bodily injury claim by debtor did not result in an abandonment of the claim).

3. Amendment of Debtor's Claim for Property Is Barred By Debtor's Bad Faith, as well as Prejudice to the Trustee and the Estate.

If the claims involved in the State Court Action were not abandoned, the Debtor maintains that he nonetheless is entitled to the proceeds of the settlement in the State Court Action because such proceeds have been exempted by him. This argument is not based on Debtor's original claim for property exemptions which stated "None" in the section in which claims or causes of action could be claimed as exempt. Instead, the Debtor relies upon an amended claim for property exemptions that was filed on February 25, 2002, following the settlement in the State Court Action. The Trustee has objected to Debtor's amended claim for property exemptions and contends that the Debtor is not entitled to amend his exemptions in order to claim the proceeds of the settlement as exempt property. Alternatively, the Trustee contends that even if the amendment is allowed, the proceeds from the State

Court Action do not constitute property that can be exempted under N.C. Gen. Stat. § 1C-1601(a)(8), under which "compensation from personal injury" may be exempted.

a. Bad Faith.

Rule 1009 of the Federal Rules of Bankruptcy Procedure provides that a voluntary petition, list, schedule or statement may be amended "as a matter of course . . . at any time before the case is closed." The reference to "schedule" in Rule 1009 includes the schedule or claim for exemptions. See In re Cudeyro, 213 B.R. 910, 915 (Bankr. E.D. Pa. 1997). Rule 1009 represents a "permissive approach" to amendment of bankruptcy schedules and, ordinarily, a court does not have discretion to deny leave to amend the schedules or to require a showing of good cause before an amendment is allowed. See Tignor v. Parkinson, 729 F.2d 977, 978 (4th Cir. 1984). Nevertheless, as recognized in Tignor, exceptional circumstances such as bad faith on the part of a debtor or prejudice to the trustee or creditors may prevent the debtor in bankruptcy from amending the petition or schedules. See id. at 979; In re Doan, 672 F.2d 831, 833 (11th Cir. 1982). Neither bad faith nor prejudice are presumed merely because of delay in claiming an exemption or because the amendment, if allowed, will result in property being exempted from the estate. See Tignor, 729 F.2d at 979. Instead, bad faith generally is determined from the totality of the circumstances. See In re Kaelin, 271 B.R. 316, 321

(8th Cir. BAP 2002). And, one circumstance that is strongly indicative of bad faith is an attempt on the part of the debtor to conceal an asset. See In re Cudeyro, 213 B.R. at 918.

Based upon the totality of the circumstances presented in the present case, the court finds bad faith on the part of the Debtor related to purported amendment to his claim for property exemptions. From the outset of this case, there has been an effort on the part of the Debtor, first to conceal the State Court Action, and then to inaccurately minimize its true value. When this case was filed, the Debtor failed to disclose the State Court Action in either the schedules or the statement of financial affairs. This occurred even though the State Court Action was filed only two months before the filing of this case, and hence was recent history and fresh in Debtor's memory. Debtor obviously was aware of the necessity of disclosing pending litigation because he did disclose in his statement of financial affairs the other Attronica suit in Maryland in which he was defendant and the suit involving his former wife. Additionally, when he was examined by the Trustee at the § 341 meeting, the Debtor was asked whether he was aware of any property in which he was claiming an interest that was not listed in his schedules. Again, the defendant failed to disclose the recently filed State Court Action when he answered in the negative. Defendant's uncorroborated testimony that he told his bankruptcy attorney about the State Court Action and was told by the attorney

that he did not need to list or disclose the State Court Action was not credible and is not accepted as the reason for his failure to disclose the State Court Action in his schedules and statement of financial affairs.

The State Court Action was first disclosed by the Debtor when the motion for relief from stay was filed on August 8, 2000. The filing of this motion brought the State Court Action to the attention of the Trustee and prompted him to inquire about the merits and value of the suit. The response from the attorneys handling the suit for the Debtor was that the suit was of minimal value and in the nature of a counterclaim to offset the claims being asserted against the Debtor, which misrepresented the purpose and value of the State Court Action. The fact that the State Court Action actually involved an effort to recover damages on behalf of the Debtor and had substantial value finally was brought to the attention of the Trustee in April of 2001. However, this information came from the attorney representing the defendants in the State Court Action and not from the Debtor or his attorneys. The Trustee began to attempt to communicate with the attorney representing the Debtor in the State Court Action, first by telephone calls, and then through letters to the attorney. The written communications to Debtor's attorney established that the Trustee made it absolutely clear that the Trustee's position was that the claims involved in the State Court Action were property of

the bankruptcy estate and that the Trustee had an interest in the claims. These points were reiterated to Debtor's attorney in letters dated July 19, 2001, September 19, 2001, October 15, 2001, and November 19, 2001. In these letters the Trustee requested that the attorney keep the Trustee updated on the progress of the action and any efforts to settle the case, requested a copy of his contract for legal services and also informed Debtor's attorney that the bankruptcy court would have to approve any settlement in the State Court Action. When no recognition of the Trustee's interest in the State Court Action was forthcoming from Debtor's attorneys, the Trustee wrote to the attorneys advising that a determination would be sought from the bankruptcy court regarding the status of the claims in the State Court Action and specifically requesting that the State Court Action not be settled until such a determination could be obtained. Notwithstanding all of these communications, the Debtor and his attorneys proceeded to conclude a settlement in which the sum of $90,000.00 was paid in settlement of the claims in the State Court Action. This was done without notice to the Trustee and without any participation on the part of the Trustee. By proceeding in this manner, the Debtor and his attorneys were able to conclude the settlement without any input or oversight by the Trustee and before the matter could be brought before the bankruptcy court. The matter was handled in this way in an effort to convert the settlement into one in which the

settlement proceeds thereafter could be claimed as exempt pursuant to N.C. Gen. Stat. § 1C-1601(a)(8) by means of an amended claim for property exemptions. Then, without court approval of the employment of the attorneys or the amount of the fees and expenses to be paid to the attorneys, the attorneys were paid in excess of $57,000.00 from the settlement proceeds. See In re Clark, 274 B.R. at 138. The settlement and the payment to the attorney occurred before Debtor's amended claim for property exemptions was filed and at a time when the claims involved in the State Court Action and the settlement proceeds were property of the estate and after Debtor and his attorney had been so advised in communications in which they also had been advised that any settlement in the State Court Action was required to be approved by the bankruptcy court.[1] Debtor and his attorney thus dealt with property of the estate in a manner that was not authorized, which was contrary to the explicit request of the Trustee, the lawful representative of the bankruptcy estate, and which was intended to prejudice the Trustee's claim position that the claims and any settlement proceeds were property of the bankruptcy estate. Moreover, they did so with the knowledge that the Trustee was seeking a determination in the bankruptcy court regarding the State Court

[1]Pursuant to Rule 9019, a settlement involving property of the bankruptcy estate must be approved by the court and creditors and other parties in interest must be provided notice and an opportunity for hearing with respect to such a settlement. See In re Masters, Inc., 149 B.R. 289 (E.D.N.Y. 1992).

claims, apparently in order to conclude a settlement before the matter could be addressed in the bankruptcy court. The court is satisfied that the foregoing circumstances reflect bad faith on the part of the Debtor which is a complete bar to the purported amendment to Debtor's claim for property exemptions. The result is that the Attronica settlement proceeds were property of the bankruptcy estate in this case when the settlement occurred and have not been exempted from the estate by the Debtor.

b. Prejudice to Trustee and the Estate.

An additional reason for not allowing the amendment is that under the circumstances of this case, the amendment of Debtor's claim for property would result in prejudice to the Trustee and the bankruptcy estate. As noted earlier, mere delay in filing an amendment to exemptions, standing alone, is not sufficient to show prejudice. However, prejudice may be established by showing harm to the litigating posture of the Trustee. See In re Daniels, 270 B.R. 417, 426 (Bankr. E.D. Mich. 2001)(quoting In re Talmo, 185 B.R. 637, 645 (Bankr. S.D. Fla. 1995)). "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." Id. "Moreover, an amendment is prejudicial if it impairs a trustee in the diligent administration of the estate." Id. See also In re Cudeyro, 213

B.R. 910 (Bankr. E.D. Pa. 1997).

In the present case, the Debtor delayed the filing of his amendment to claim for property exemptions until after he settled the State Court Action, which allowed the Debtor and his attorneys a free hand in structuring the settlement as a personal injury matter rather than as a claim for unpaid compensation and other non-exemptible monetary losses of the types described in the complaint that earlier had been filed as an exhibit to the motion for relief from stay. Had the exemption amendment been filed earlier, the Trustee would have been aware of the exemption issue and could have maintained a litigation posture involving direct involvement in the negotiation and consummation of any settlement in the State Court Action. Absent the delay in filing the amendment, the Trustee could have altered his approach and interceded in the State Court Action prior to any settlement and could have sought and obtained a determination in the bankruptcy court when he would not have been faced with a settlement tailored to look like a personal injury settlement. The delay in filing the amendment thus was prejudicial to the Trustee, as well as a component of the Debtor's bad faith.

4. Debtor's Motion to Amend the Order Entered on November 7, 2000.

When this case was filed, the Debtor owned a half interest in a residence with his former wife. Marital litigation between the Debtor and his former wife was pending involving the residence and

other marital matters. On September 25, 2000, the Trustee filed a motion for approval of a settlement with Debtor's wife under which the Trustee would convey the half interest of the Debtor to the wife in exchange for a payment of $25,000.00 from the wife and a release by the wife of any further claim in this bankruptcy case. The order approving this settlement was entered on November 7, 2000, following a hearing on the proposed settlement on October 24, 2000. It is this order that the Debtor seeks to amend.

In the motion to amend the Debtor asserts that prior to the hearing on October 24, 2000, the Trustee stated to him that "he had no interest in the Maryland State Court proceeding nor any proceeds therein . . . ." Debtor asserts that he relied upon the Trustee's statement in agreeing to the settlement with his former wife and that the November 7, 2000 order "should be amended to fully reflect the nature of the hearing and agreement between the Parties at that time." Debtor's prayer for relief is that an order be entered amending the November 7 order "by Ordering the Trustee to abandon the property contained in the civil action in Maryland. . . and any proceeds therefrom."

As the party seeking an amendment to the November 7, 2000 order, the burden is on the Debtor to show a factual and legal basis for the requested amendment. Debtor showed neither. The evidence offered by the Debtor was insufficient to show by a preponderance any agreement or other basis for finding that the

Trustee was conceding in the settlement that the bankruptcy estate would have no further interest in the claims asserted in the State Court Action or that the Trustee was agreeing to an abandonment of such claims. In actuality, the settlement under consideration at the time had nothing whatever to do with the State Court Action. Moreover, as noted earlier, even if there had been such an agreement by the Trustee, which was not shown by the evidence, without specific notice to creditors and a hearing pursuant to § 554, such agreement would have been ineffective. See Sierra Switchboard Co. v. Westinghouse Elec. Corp., 789 F.2d at 710. Further, having considered the credibility of the witnesses, the court further finds that the Trustee did not make any statements regarding the State Court Action which reasonably could have been interpreted or relied upon as an abandonment of such claims. It follows that the Debtor is not entitled to have the order that was entered on November 7, 2000, amended in order to effect an abandonment of the claims involved in the State Court Action.

CONCLUSION

In accordance with the foregoing findings and conclusions, an order will be entered contemporaneously with the filing of this memorandum opinion sustaining the Trustee's objection to the amended claim for exemptions filed by the Debtor on February 25, 2002, denying the Debtor's motion to amend the order that was entered on November 7, 2000 and granting the Trustee's motion for

the turnover of the settlement proceeds referred to in the motion.

This 28th day of May, 2002.

William L. Stocks

WILLIAM L. STOCKS
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
GREENSBORO DIVISION

IN RE:	)	
	)	
Mack L. Scott,	)	Case No. 00-10993C-7G
	)	
Debtor.	)	
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ORDER

In accordance with the memorandum opinion filed contemporaneously herewith, it is ORDERED, ADJUDGED AND DECREED as follows:

1. The Trustee's objection to the amended exemptions filed by the Debtor is sustained and the amendment to Debtor's claim for property exemptions is disallowed;

2. The Debtor's motion to amend the order that was entered in this case on November 7, 2000, is denied; and

3. The Trustee's motion to compel the Debtor to turn over proceeds is granted and the Debtor is hereby ordered to turn over to the Trustee all of the settlement proceeds realized from the settlement with Attronica Computers, Inc. which are in the possession or control of the Debtor.

This 28th day of May, 2002.

William L. Stocks

WILLIAM L. STOCKS
United States Bankruptcy Judge