



ENTERED

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The following constitutes the order of the Court.

Signed February 7, 2005.

United States Bankruptcy Judge

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION**

IN RE:

JAY and CAREY BOWEN,

Debtors.

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CASE NO. 03-43409-rfn-7

MEMORANDUM OPINION AND ORDER

Before the Court are the Objection to Exemptions Filed by Jane Weckherlin (“Weckherlin”) and the Objection to Debtors’ Claim of Exemption and Joinder in Objection Filed by Jane Weckherlin filed by the Chapter 7 Trustee (the “Trustee”). The Court held a hearing on this matter on December 13, 2004, and having heard argument of counsel and the Trustee, and the testimony of Jay Bowen (“Mr. Bowen”), took the matter under advisement.

This Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 1334 and 157. Objections to exemptions are core proceedings pursuant to 28 U.S.C. § 157(b)(2)(B). This Memorandum Opinion and Order constitutes the Court's findings of fact and conclusions of law in accordance with FED. R. CIV. P. 52 and Rules 7052 and 9014, FED. R. BANKR. P. After careful consideration of the pleadings, evidence, relevant authorities, and arguments of counsel, including the parties' letter briefs, the Court concludes that Weckherlin's and the Trustee's objections should be overruled. The Court's analysis is set forth below.

I. BACKGROUND

The Debtors filed a voluntary petition for relief under Chapter 13 on April 9, 2003. On May 8, 2003, Debtors filed their Schedules A-J. Among the assets listed by Debtors were real property located at 1108 W. Cleburne Rd., Crowley, Texas (the "Homestead"), an annuity with Nationwide Life Insurance Company (the "Annuity"), an interest in a profit sharing plan (the "Plan"), and 1000 shares of stock in Bowen Research and Development, Inc. (the "Stock"). In their Schedules, Debtors claimed each of the foregoing interests, and certain other property, exempt under 11 U.S.C. § 522(b)(1) (the "federal exemptions"). Specifically, Debtors exempted the Homestead pursuant to section 522(d)(1), the Stock under section 522(d)(5), and the Annuity and Plan under section 522(d)(10)(E).¹

On October 8, 2003, Weckherlin filed an objection to Debtors' exemptions of the Homestead, Annuity, Plan and Stock.² Weckherlin objected to the Debtors' exemption

¹ All chapter, section and code references are to Title 11 of the U. S. Code (the Bankruptcy Code) and rule references are to the Federal Rules of Bankruptcy Procedure, Rules 1001-9036, unless otherwise noted.

² Weckherlin is Mr. Bowen's ex-wife. Weckherlin is listed in Debtors' Amended Schedule F as an unsecured creditor holding a claim for \$79,679.39 arising from a 2002 "Property settlement from divorce."

of the Homestead and Stock based, in part, on valuation issues, and to the Annuity and Plan as not properly within the scope of section 522(d)(10)(E). On May 4, 2004, Debtors amended their schedules, but continued to assert the federal exemptions. The Court held a hearing on Weckherlin's objections and, on July 6, 2004, issued a Memorandum Decision and Order sustaining her objections with respect to the Annuity, Plan and Stock, but overruling her objection with respect to the Homestead. The Court ruled that Debtors failed to demonstrate that the Annuity and Plan were reasonably necessary for their support or for the support of their dependents and, therefore, could not be exempted under section 522(d)(10)(E).³

On April 21, 2004, while her initial objection to Debtors' exemptions was still pending, Weckherlin filed a motion to convert the case to Chapter 7. Debtors opposed the motion, but at the hearing on the motion withdrew their objection. On September 7, 2004, the motion was granted and the case was converted to Chapter 7.

On September 15, 2004, the Trustee wrote Debtors demanding turnover of the Annuity and an accounting. On September 16, 2004, the Trustee changed the status of the case to an asset case and sent out notice of the proof of claim bar date to creditors. On September 29, 2004, Debtors turned over \$99,432.24 to the Trustee. This amount included the proceeds from the now liquidated Annuity. The Trustee holds these funds in an estate account.

On September 27, 2004, Debtors again filed amended schedules and statement of financial affairs. This time, Debtors changed their exemption election from federal to state law under section 522(b)(2) (the "state exemptions"). Debtors now claim the

³ Debtors terminated the Plan post-petition, and each opened an IRA with their respective shares of the Plan proceeds.

Annuity is exempt pursuant to Tex. Ins. Code § 1108.051. Debtors list the Annuity as having a value of \$84,640.41, and, as they did under federal law, claim the entire amount exempt.

II. CONTENTIONS OF THE PARTIES

Weckherlin objects to Debtors changing their exemption claims from federal to state law. She contends that she and other creditors are prejudiced by the amendment because: (1) for sixteen months she detrimentally relied not only on Debtors' claim of federal exemptions, but on their failure to claim the state exemptions in the alternative; (2) she spent time, effort, and incurred legal fees in objecting to Debtors' federal exemptions; (3) she and other creditors would be deprived of the non-exempt funds should the amendment be allowed; and (4) she changed her litigating posture based upon the Debtors' claim under the federal exemptions.⁴

Weckherlin also contends that Debtors' amendment is in bad faith. She asserts that Debtors have engaged in disingenuous and manipulative conduct throughout the course of their case. She charges that Debtors intended to change their exemption claims to state law all along, but waited to do so until after she incurred legal fees litigating her objections to the federal exemptions. She asserts that Debtors previously represented that the assets they now claim as exempt would go to the Internal Revenue Service ("IRS"), and that Debtors changed their exemptions only after they determined that the Stock did not have any value. In her letter brief, Weckherlin asserts that Debtors (1) intentionally

⁴ In her objection and letter brief, Weckherlin also requests that the Court declare the Annuity non-exempt "due to its non-qualified nature." However, Weckherlin has provided no authority for the assertion that the Annuity is non-qualified. As the objecting party, Weckherlin bears the burden of proving the exemption is not properly claimed. *See* discussion *supra*. In the absence of such a showing, Weckherlin's objection on this basis is denied.

caused the Chapter 13 Trustee to move to dismiss their case so that they could cash and spend the Annuity for themselves, (2) filed an opposition to the motion to convert with no real intent to object and then withdrew it at hearing, (3) obtained continuances for purposes of delay, (4) litigated the objection to federal exemptions without any intent to introduce “reasonable and necessary” evidence to support their exemption of the Annuity, and (5) failed to turn over all of the Annuity proceeds to the Trustee.

The Trustee joins in Weckherlin’s objection. The Trustee argues that Debtors’ amendment is prejudicial and in bad faith because Debtors waited to amend their exemptions until after the Court entered its order addressing Weckherlin’s initial objections. The Trustee asserts that he relied upon the Court’s order and Debtors’ failure to appeal or otherwise challenge the order as evidenced by his (1) delivering the demand letter to Debtors’ counsel requiring turnover of the Annuity and an accounting, (2) changing the case to an asset case, and (3) sending out notice of the proof of claim bar date to creditors.⁵ The Trustee also asserts that Debtors have not provided a complete accounting and reserves further objection until they do.

III. LEGAL ANALYSIS

Rule 1009(a) of Federal Rules of Bankruptcy Procedure provides that debtors may amend their schedules “as a matter of course” at any time before the case is closed. Bankruptcy Rule 1009(a) provides:

A voluntary petition, list, schedule, or statement may be amended by the debtor as a matter of course at any time before the case is closed.

⁵ In his objection, the Trustee states that the “Debtors are bound by the Court’s Order, which is final and non-appealable.” At the hearing, the Court inquired as to whether the objecting parties were asserting that the proposed amended exemptions were precluded by the Court’s previous order. Neither indicated they were. In the absence of such a contention, the Court does not address whether Debtors’ amended exemptions could be disallowed on this basis.

The rule is liberal and continues the permissive approach of former Bankruptcy Rule 110 in allowing amendments of voluntary petitions and accompanying papers at any time before the case is closed. This liberal rule, however, is not without limits. Bankruptcy courts can disallow an amendment upon a showing of bad faith or prejudice to creditors. *Stinson v. Williamson (In re Williamson)*, 804 F.2d 1355, 1358 (5th Cir. 1986).

The party objecting to the amendment bears the burden of demonstrating prejudice or bad faith. *In re Cudeyro*, 213 B.R. 910, 918 (Bankr. E.D. Pa. 1997); *see also In re Harrington*, 306 B.R. 172, 181 (Bankr. E.D. Tex. 2003) (Rule 4003(c) requires that the objecting party bear the burden of proving that the exemptions are not properly claimed).

A. Weckherlin's Claims of Prejudice

Delay alone in filing an amendment does not constitute prejudice. *Doan v. Hudgins (In re Doan)*, 672 F.2d 831, 833 (11th Cir. 1982). Nor does prejudice occur “merely because an amendment, if properly allowed, permits the debtor to assert a claim that ultimately prevails on the merits.” *Williamson*, 804 F.2d at 1358 (citation omitted). Rather, prejudice arises when a party has acted in reliance upon the debtor’s schedules and, having taken action based on those schedules, is prejudiced if amendments are allowed. *See Cudeyro*, 213 B.R. at 919 (debtor’s amendment exempting proceeds from settlement of litigation disallowed after debtor had settled exemption claim with trustee and trustee relied on settlement in making distributions from such proceeds); *see also In re Knapp*, 283 B.R. 819 (Bankr. W.D. Pa. 2002) (debtor’s amendment at conclusion of case claiming lawsuit exempt prejudiced trustee who relied on initial schedules in pursuing settlement); *In re Talmo*, 185 B.R. 637

(Bankr. S.D. Fla. 1995) (amendment prejudiced creditors where debtor waited to exempt property until after trustee procured order authorizing sale of that property); *Grzesnikowski v. Shaffer (In re Shaffer)*, 92 B.R. 632 (Bankr. E.D. Pa. 1988) (prejudice found where creditor did not object to prior distributions of funds to debtor because of creditor's expectation that his claim would be paid out of assets not originally claimed as exempt).

Weckherlin asserts that she relied on Debtors' federal exemptions and was prejudiced because she incurred legal fees in objecting to those exemptions. However, incurring legal expenses in pursuit of an objection to a debtor's claim of exemptions is not the type of prejudice found in the cases that address this issue. Instead, the typical scenario in which prejudice is found is where expenses have been incurred by the estate in order to recover or monetize an asset for the benefit of creditors, only to have the debtor then amend his exemptions to include the asset. The Court has found no case which holds that incurring legal costs objecting to one set of exemptions is prejudice that precludes a debtor from amending to elect a different set of exemptions.

Next, Weckherlin claims prejudice because if the amendment is allowed she and other creditors will be "deprived of the non-exempt funds." *Williamson* makes clear, however, that the inability of creditors to ultimately recover from an exempt asset does not constitute grounds for denying an amendment under Rule 1009(a). In *Williamson*, the court considered whether a debtor, who initially claimed federal exemptions, should be allowed to amend his exemptions to assert a state homestead exemption. Answering affirmatively, the court rejected the creditors' argument that they would be prejudiced because their judgment claims would go unsatisfied:

This argument [that the judgment liens will go unsatisfied] misconstrues the question of prejudice. It [the argument] focuses on the ultimate outcome of the action rather than the harm to the creditor's litigating posture because of some detrimental reliance on the debtor's initial position. Prejudice to the creditor's legal or equitable position does not occur merely because an amendment, if properly allowed, permits the debtor to assert a claim that ultimately prevails on the merits.

Id. at 1358 (citation omitted). Consequently, Weckherlin's assertion of prejudice on this basis is without merit.

Weckherlin attempts to demonstrate prejudice to her litigating posture by arguing that she was prejudiced because she relied on Debtors' exemptions when, for sixteen months, she fought Debtors' federal exemptions.⁶ According to Weckherlin, during that time, Debtors never pled -- even in the alternative -- their entitlement to the state exemptions. In essence, Weckherlin argues that she detrimentally relied upon Debtors' claiming an exemption that Weckherlin herself contended was invalid. Her argument is that she will be prejudiced if Debtors are now permitted to claim a legally sustainable exemption. While the time and expense devoted by Weckherlin in pursuing the objection are apparent, the harm to her litigating posture is not. Mere passage of time and incurring of legal expenses do not constitute harm to a party's litigating posture. Instead, "[i]f 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." *In re Talmo*, 185 B.R. 637, 645 (Bankr. S.D. Fla. 1995).

In further effort to demonstrate harm to her litigating posture, Weckherlin argues that had Debtors claimed the state exemptions earlier in the case, Weckherlin would have

⁶ The Court notes that while Weckherlin asserts that she fought Debtors' exemptions for sixteen months, her objection was not filed until October 2003. The Court's ruling on the federal exemptions was issued in July 2004, eight months later.

permitted the chapter 13 case to be dismissed and she would have pursued Debtors in state court. Instead, Weckherlin says she permitted Debtors' case to be converted to chapter 7, thus enabling Debtors to discharge creditors' claims. Even assuming that Weckherlin would have pursued this alternative litigation strategy, the harm to her litigating posture is not evident. After all, the dismissal that Weckherlin "would have permitted" was without prejudice to the rights of Debtors to refile a petition in bankruptcy. Upon refiling, Debtors could have then claimed the state exemptions, leaving Weckherlin in the same litigating posture in which she finds herself today. Accordingly, Weckherlin's objections based on prejudice are overruled.

B. Weckherlin's Claims of Bad Faith

Weckherlin also contends that Debtors' amended exemptions should not be allowed because they have acted in bad faith. In *McFatter v. Cage*, 204 B.R. 503, 508 (S.D. Tex. 1996), the court observed that "under Fifth Circuit analysis, bad faith generally requires concealment of an asset or an exemption of which the creditors have no knowledge and thus no opportunity to investigate." Indeed, according to *McFatter*, in order to find bad faith, "there must be some form of deception." *Id.*

Weckherlin does not claim that Debtors concealed assets or exemptions. To the contrary, the evidence is that Debtors not only fully disclosed the Annuity when they filed their petition in bankruptcy, but that they purported to exempt it from the start.

Instead, Weckherlin alleges other deceptive conduct by the Debtors. She alleges that Debtors delayed amending their exemptions as part of a strategy to cause Weckherlin to expend time and money objecting to their federal exemptions. However, at the hearing on Weckherlin's objections, Mr. Bowen testified that his decision to amend Debtors'

exemptions was made after Weckherlin filed her motion to convert Debtors' case to chapter 7. The credible evidence of records does not support Weckherlin's allegation that Debtors knowingly caused Weckherlin to incur unnecessary legal expenses in pursuing her objection.

Weckherlin also contends that Debtors acted in bad faith because they initially claimed federal exemptions when they believed that the Stock had substantial value, but switched to the state exemptions only after the Court determined that the Stock had little value. Debtors dispute this allegation; but, even it were true, it is not deceptive conduct that would support a finding of bad faith.

Weckherlin further alleges that Debtors attempted to discourage creditors from objecting to their exemptions by claiming that the Annuity, if exempted, would only go to pay the IRS. She also contends that Debtors have kept a portion of the Annuity proceeds from the Trustee. However, there is no evidence to show that the Annuity will not go to the IRS if it is exempted, nor is there any evidence that Debtors withheld a portion of the proceeds from the Trustee.

Finally, Weckherlin points to certain litigation actions or inactions by Debtors that she alleges constitute bad faith. Weckherlin alleges Debtors (1) did not pay the chapter 13 trustee the required plan payments in order to induce the chapter 13 trustee to dismiss their case, (2) sought continuances only for delay purposes, (3) filed an opposition to Weckherlin's motion to convert without intending to actually oppose the conversion, and (4) routinely filed eleventh hour responses to motions. Weckherlin offered no evidence to support these allegations, but, presumably asks the Court to take judicial notice of the record in this case in order to establish such facts. While the record

clearly manifests the legal positions and actions taken by Debtors, it does not, by itself, support a finding of deceptive conduct by Debtors. Accordingly, Weckherlin has not met her burden of showing that the amended claim of exemptions was made in bad faith.

C. The Trustee's Claims of Prejudice and Bad Faith

The Trustee joins Weckherlin in her objection. The Trustee alleges that he relied upon Debtors' claim of federal exemptions in demanding turnover and an accounting of the Annuity proceeds, in changing the case status to an asset case, and in procuring a bar date for creditors to file claims.

Debtors amended their schedules within three weeks of the date that their case was converted to chapter 7 and one day before the creditors' meeting pursuant to section 341. Consequently, any reliance by the Trustee was short lived. Moreover, while the Trustee did take actions to recover the Annuity from Debtors (which they complied with), sending a demand letter to Debtors, changing the status of the case from no-asset to asset, and sending notices of the claims bar date to creditors is not sufficient reliance on his part to establish a claim of prejudice. In short, the Trustee's efforts are not of the same magnitude as those taken by a trustee who expends substantial time and expense in attempting to recover or monetize non-exempted assets, only to have a debtor amend his exemptions to claim for himself the value created by the trustee.

The Trustee alleges that the exemption amendment is in bad faith. This allegation appears to be based upon the fact that the amendment was made over sixteen months after the federal exemptions were first claimed and then only after the Court entered its order denying the federal exemption as to the Annuity. However, delay alone does not constitute bad faith. *Arnold v. Gill (In re Arnold)*, 252 B.R. 778, 786 (B.A.P. 9th Cir.

2000). Additionally, the mere timing of Debtors' amendment of the exemption is not, by itself, evidence of deceptive conduct by Debtors.

CONCLUSION

Weckherlin and the Trustee have not met their burden of demonstrating that the Debtors' amendment of their exemptions should be disallowed because of prejudice or bad faith. Accordingly, the objections are overruled.⁷

SO ORDERED.

END OF ORDER

⁷ At least two courts have held that prejudice or bad faith must be shown by clear and convincing evidence. *See, e.g., Talmo*, 185 B.R. at 644; *Kobaly v. Sloan (In re Kobaly)*, 142 B.R. 743, 748-749 (Bankr. W.D. Pa. 1992). The Court does not decide here whether objectors must meet their burden by clear and convincing evidence or by a preponderance of the evidence. Even under the lower standard, objectors have not met their burden.