UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MICHIGAN

In re:

GAIL SUZANNE BURNS-SULKEY,

Debtor.

Case No. 07-00651
Hon. Scott W. Dales
Chapter 7

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OPINION REGARDING MOTION TO COMPEL TURNOVER AND SECOND OBJECTION TO AMENDED EXEMPTIONS

I. INTRODUCTION AND JURISDICTIONAL STATEMENT

For the reasons set forth below I sustain the Trustee's Second Objection to Amended Exemptions and grant his Motion to Compel Turnover for the recovery of the non-exempt portion of the Debtor's income tax refund (the "Refund"). In reaching my decision, I have considered the pleadings, the Debtor's amended schedules, the transcript of the hearing held on July 11, 2007 before the Honorable Jo Ann C. Stevenson, and the arguments presented on May 29, 2008.

This court has jurisdiction pursuant to 28 U.S.C. § 1334. This matter is a core proceeding as described in 28 U.S.C. § 157(b)(2)(B) and (b)(2)(E). This opinion constitutes my findings of fact and conclusions of law pursuant to Fed. R. Civ. P. 52.

II. ISSUES FOR DECISION

Notwithstanding the liberal right to amend schedules described in Fed. R. Bankr. P. 1009(a), can a debtor properly claim an amended exemption in an asset after the court has denied the claimed exemption?

III. MATERIAL FACTS

On January 31, 2007, Gail Suzanne Burns-Sulkey (the "Debtor") filed a voluntary Chapter 7 petition together with the required schedules. In Schedule A, the Debtor listed the value of her residence at 326 W. Walnut Street, Hastings, Michigan (the "Residence") as $100,000.00. On Schedule C she claimed $18,450.00 in value attributable to the Residence as exempt under 11 U.S.C. § 522(d)(1) (the "Residence Exemption"), even though Schedule D showed that the Residence was fully encumbered. Evidently ignoring the fact that the Debtor overstated her Residence Exemption, the Trustee filed an Objection to Exemptions (the "First Objection"), arguing that because the Debtor had exhausted the full amount of her Residence Exemption, the court should cap her 11 U.S.C. § 522(d)(5) exemption (the "Wild Card Exemption") at $975.00.

The Debtor filed a response to the First Objection (the "First Response"), arguing that it was untimely. On the merits, the Debtor contended that she had no equity in her home and that the Trustee had misinterpreted Schedule C in some unspecified way. See First Response at ¶5.

On July 11, 2007, Judge Stevenson held a hearing to consider the First Objection during which the Trustee explained that he objected to the Debtor's exemptions specifically to "bring in nonexempt property, such as 2006 tax

refunds *et cetera.*" See Transcript of July 11, 2007 hearing at 2. The Trustee also said he was seeking to cap or "fix what [the Debtor's] exemptions are. Then, everything after that, *there can be no argument*, is nonexempt." Id. (emphasis added). Judge Stevenson replied, "[a]lright," and then, "[y]our motion is granted," apparently accepting the Trustee's request to bar any future argument about the exempt status of any asset, including the Refund. Id. Neither the Debtor nor her counsel attended the hearing. Judge Stevenson's Order dated July 11, 2007 (the "Exemption Order") formally sustained the First Objection, and provided as follows:

> The total exemption previously claimed under §522(d)(5) in excess of $975 by the Debtor in the assets listed on Schedule B as stated in the [First Objection] is hereby **DENIED** and the Trustee's [First Objection] to that claim of exemption is **GRANTED** for the reasons stated on the record. . . "

See Exemption Order at ¶1. The Debtor did not appeal or seek reconsideration. She also did not amend her exemptions until after the Trustee sent several letters requesting the Refund and filed a Motion to Compel Turnover (the "Turnover Motion"), even assuming, *arguendo*, that the Exemption Order did not bar further amendment. Because the Turnover Motion caused the Debtor to look more closely at the Refund, she later amended Schedules B and C to increase the value of the Refund from $1,000.00 to $4,802.00 and claim it as exempt under the Wild Card Exemption. In response, the Trustee filed a Second Objection to Amended Exemptions (the "Second Objection").

IV. ANALYSIS

In support of his Turnover Motion and Second Objection, the Trustee argues that the preclusive effect of the Exemption Order bars the Debtor from claiming a Wild Card Exemption in any property in an amount beyond $975.00.

The Debtor argues the Exemption Order contains no preclusive language, and that denying her an exemption in the Refund based upon the prior order would violate Fed. R. Bankr. P. 1009(a), which provides that "[a] … schedule …may be amended by the debtor as a matter of course at any time before the case is closed."

The Debtor says the court cannot bar her from amending her Schedules because courts do not have the discretion to reject amendments unless the Debtor has acted in bad faith or has concealed property. See Debtor's Reply to Trustee's Second Objection at ¶6. The Debtor's case citations clearly support a liberal amendment policy with respect to exemptions, but none of them addresses the effect of a prior order disallowing exemptions on the right to amend Schedule C.[1]

Judge Spector, in a decision involving the preclusive effect of an order overruling a debtor's claimed exemption, persuasively observed:

> Bankruptcy courts should disallow an amended claim of exemption where the purpose and/or the effect of the amendment is to allow the debtor to relitigate an exemption claim which has already been determined by the court. In re

[1] See In re Iwasko, 2006 WL 2855040 (Bankr. E.D. Mich.); In re Basch, 341 B.R. 615, 623 (Bankr. W.D. Mich. 2006) (citing Lucius v. McLemore, 741 F.2d 125, 126-27 (6th Cir. 1984)).

> Grantham, 256 B.R. 262, 263-64 (Bankr. M.D.Tenn. 1999); 9 Collier on Bankruptcy, ¶ 1009.02[1], at 1009-4 ("The right to amend the various statements and schedules does not mean, however, that the debtor has an unfettered right to alter previously settled rights of affected entities.").

In re Daniels, 270 B.R. 417, 422 (Bankr. E.D. Mich. 2001); see generally Vogel v. Kalita (In re Kalita), 202 B.R. 889, 893-94 (Bankr. W.D.Mich. 1996) ("*res judicata* bars a second action on the same claim or cause of action including all matters that were raised or could have been raised in the first action" and "forecloses all that which might have been litigated previously"). In other words, *res judicata* does not limit the Debtor's right to file an amended exemption but it does limit the Debtor's right to relitigate exemption issues already resolved in a prior order. And, no matter when or under what circumstances a debtor amends her exemptions, the amendment remains subject to objection. Compare Fed. R. Bankr. P. 1009(a) (general right to amend) with Fed. R. Bankr. P. 4003(b)(1) ("a party in interest may file an objection to the list of property claimed as exempt within . . . 30 days after any amendment to the list . . . is filed . . . "); Lucius v. McLemore, 741 F.2d at 126. By analogy, the liberal amendment policy expressed in Fed. R. Civ. P. 15(a) does not bar a defendant from challenging a plaintiff's amended allegations at trial or by pretrial motion. A liberal amendment policy does not insulate claims from judicial review.

If Judge Stevenson erred by entering the Exemption Order, the Debtor should have filed an appeal under Fed. R. Bankr. P. 8001, or moved to alter or amend the judgment under Fed. R. Bankr. P. 9023, or for relief from the order under Fed. R. Bankr. P. 9024. Reliance upon Fed. R. Bankr. P. 1009(a) is not a

substitute for judicial review, given the central role that finality and *res judicata* play in litigation. Just as parties in interest rely on court orders when arranging their affairs, the Trustee may rely on court orders when administering estate assets. Courts must protect this reliance and the finality of their orders.

Although the Debtor has blamed the Trustee for misinterpreting the original Schedule C and advancing a "clever" interpretation, the Trustee's interpretation of Schedule C was straightforward: the Debtor unequivocally claimed $18,450.00 under the Residence Exemption, thereby exhausting any spillover under the Wild Card Exemption, and the Trustee took her at her word. So did Judge Stevenson.

Practically speaking, exemption practice is akin to old-fashioned horse trading, and the parties' perceptions of value influence their choices. Because no one really knows what property is worth until after an arms-length sale, no one can really make entirely accurate predictions when claiming, or objecting to, exemptions. It is possible that the Debtor's $100,000.00 estimate of the Residence's value was reasonably accurate. Yet, at the petition date, she may have harbored some hope that the Residence was worth more than that, and that its value would rise over time. On the other hand, the Trustee probably regarded the Residence as fully-encumbered and therefore worthless to the bankruptcy estate. He instead decided to pursue the Debtor's personal property, including the Refund, for the benefit of creditors. Judge Stevenson approved this choice, over objection, when she entered the Exemption Order.

In any event, I find the Trustee is not obligated to correct what appears to be the Debtor's unwise use of the Residence Exemption. Nor did the Trustee engage in sharp practice. A bankruptcy trustee has no duty to object to an overstated exemption if doing so is incompatible with the interest of creditors. In addition, the Debtor had notice and an opportunity to be heard prior to the entry of the Exemption Order, and she had appellate rights thereafter. Although she advanced written arguments against the Trustee's supposed "misinterpretation" of Schedule C, she failed to appear at the hearing on July 11, 2007, and lost the argument.

At this point in the Debtor's case, after the Trustee has taken steps to collect the Refund and otherwise administer the property of the estate based on the Exemption Order and the Debtor's original Schedule C, it is not equitable to allow the amended exemption to stand.

Other courts have recognized that prejudicial delay or *laches* -- in addition to bad faith and concealment -- may prevent a Debtor from successfully amending exemptions:

> 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. Mere delay in filing an amendment, or the fact that an amendment if allowed will result in the exemption being granted, are not sufficient to show prejudice..... [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.

In re Daniels, 270 B.R. at 426 (quoting In re Talmo, 185 B.R. 637, 645 (Bankr. S.D.Fla. 1995)); see also Gold v. Guttman (In re Guttman), 237 B.R. 643, 651 (Bankr. E.D.Mich. 1999) (the court may disallow amendments based on a finding of bad faith or prejudice to creditors, notwithstanding Fed. R. Bankr. P. 1009(a)); but see In re Iwasko, 2006 WL 2855040 (Bankr. E.D. Mich.) (rejecting In re Daniels).

"An amendment is prejudicial if it impairs a trustee in the diligent administration of the estate." In re Daniels, 270 B.R. at 426. In the present case, the Trustee has claimed without contradiction that he has relied on the Exemption Order and the Debtor's original Schedule C in conducting the administration of the case. Taking steps to confine the Wild Card Exemption last July, seeking turnover of the Refund, attending several hearings on the issue – each action bolsters the Trustee's assertion that he relied on the original Schedule C and the Exemption Order. The Debtor, in contrast, has refused to acknowledge she overstated her original Residence Exemption until roughly nine months after Judge Stevenson entered the Exemption Order, after the Trustee filed his Turnover Motion, and after the Debtor took a closer look at the Refund. Consequently, upholding the Debtor's amended exemptions this late in the case would hinder the Trustee in performing his duty to "collect and reduce to money the property of the estate . . . and close such estate as expeditiously as is compatible with the best interests of parties in interest." 11 U.S.C. § 704(a)(1). I cannot tolerate that.

V. DISPOSITION

For the foregoing reasons, I will sign a separate order granting the Turnover Motion and sustaining the Second Objection.

Dated: June 12, 2008
at Grand Rapids, Michigan

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Scott W. Dales
United States Bankruptcy Judge