SIGNED this 29 day of March, 2007.

R. Thomas Stinnett
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE
SOUTHERN DIVISION

In re: No. 03-17884
Chapter 7

RUBY CORNELIA MATHIS,

Debtor.

Appearances: Richard P. Jahn, Jr.; Shanna C. Aderhold, for Richard P. Jahn, Jr., Trustee

W. Thomas Bible, for Ruby Cornelia Mathis, Debtor

R. Thomas Stinnett, United States Bankruptcy Judge

MEMORANDUM

The bankruptcy trustee has filed an objection to the amended claim of exemptions filed by the debtor, Ruby C. Mathis. The debtor seeks to exempt the net proceeds from settlement of her claim in a class action lawsuit against a drug manufacturer. The class

action was pending when the debtor filed this bankruptcy case, but she did not list the claim or otherwise disclose it to the bankruptcy trustee before the bankruptcy case was closed. She also did not disclose the class action claim after bankruptcy when she was informed of the proposed settlement. The trustee learned of the class action and the proposed settlement from the debtor's lawyers in the class action and filed a motion to re-open the debtor's bankruptcy case. After the bankruptcy case was re-opened, the trustee settled the debtor's class action claim, and he has received most of the net proceeds. He contends the debtor should not be allowed any exemption from the net proceeds because she concealed the lawsuit during and after the bankruptcy case despite her legal duty to disclose it.

Generally, the debtor can claim an exemption in a bankruptcy case at any time before the case is closed. This same rule applies in a re-opened bankruptcy case. Fed. R. Bankr. P. 1009(a); *Goswami v. MTC Distributing (In re Goswami)*, 304 B.R. 386 (9th Cir. B.A.P. 2003). The archetypal argument against an exemption is that no federal or state statute makes the property exempt. In bankruptcy cases, however, the federal courts have created other grounds for denying an exemption. In particular, the bankruptcy court can deny an exemption if the debtor concealed the exemptible property. This rule enforces the provisions of bankruptcy law that require the debtor to make a full and honest disclosure of all assets. *Bauer v. Iannacone (In re Bauer)*, 298 B.R. 353 (8th Cir. B.A.P. 2003); *Sheehan v. Lincoln Nat. Life*, 257 B.R. 449 (N. D. W. Va. 2001).

"Concealment" of exemptible property might be taken to mean failure to disclose the property for any reason. The courts have not adopted such a strict rule. They have denied the exemption when the debtor acted in bad faith. "Bad faith" is a general term that covers fraud or other forms of dishonesty. The question seems to be whether the debtor knew the property should be disclosed in the bankruptcy case and decided not to disclose it so that it would be

protected from the effects of bankruptcy. *Sheehan v. Lincoln Nat. Life*, 257 B.R. 449 (N. D. W. Va. 2001); *Wood v. Premier Capital, Inc. (In re Wood)*, 291 B.R. 219 (1st Cir. B.A.P. 2003); *In re McKain*, 325 B.R. 842 (Bankr. D. Neb. 2005); *In re Colvin*, 288 B.R. 477 (Bankr. E. D. Mich. 2003); *see also In re McKain*, 325 B.R. 842 (Bankr. D. Neb. 2005) (no serious regard for duty to disclose as equivalent to bad faith).

Did the debtor realize the need to disclose the class action lawsuit and decide against it because she wanted to protect it from bankruptcy? The court must consider all circumstances when deciding whether to allow an exemption in property that was not listed or otherwise disclosed in the bankruptcy case. *In re Colvin*, 288 B.R. 477 (Bankr. E. D. Mich. 2003); *In re Clemmer*, 184 B.R. 935 (Bankr. E. D. Tenn. 1995). The basic facts are undisputed, but the debtor's testimony as to her intent is subject to different interpretations. The court finds the facts as follows.

In the 1990's the debtor took the weight-loss drug known as fen-phen. In the late 1990's the debtor saw an advertisement on television suggesting that people who had taken fen-phen could be entitled to recover damages from the manufacturer. The debtor hired a local lawyer to represent her, but she later became a plaintiff in a class action lawsuit against the maker of the drug. The plaintiffs in the class action were represented by a Texas law firm, Fleming and Associates. About every seven to eight months, the debtor received a report from the local lawyer or from Fleming and Associates about the status of the class action.

The debtor filed her bankruptcy case on November 17, 2003. The debtor did not list the fen-phen lawsuit in the asset schedules. The statement of financial affairs specifically asked the debtor to list lawsuits and legal proceedings in which she was a party or had been a party within the preceding year. The debtor did not list the fen-phen lawsuit in response to the question. The debtor has not argued that she revealed the lawsuit to her bankruptcy lawyer who

inadvertently failed to list it in the asset schedules or the statement of financial affairs. The debtor did not disclose the existence of the lawsuit to the bankruptcy trustee during the meeting of creditors or at any other time before the bankruptcy case was closed. The debtor received a discharge of her debts in the bankruptcy case, and the case was closed as a no-asset case in March 2004.

Fleming and Associates subsequently notified the debtor of a proposed settlement of her claim in the class action lawsuit. They sent the debtor a questionnaire that asked if she had filed a bankruptcy case. The debtor revealed that she had filed a bankruptcy case. The debtor did not contact her bankruptcy lawyer or the trustee about the potential recovery in the fen-phen suit.

The debtor must had given the class action lawyers more information about the bankruptcy case, however, since they contacted the bankruptcy trustee around the middle of 2006. They informed the trustee of a proposed settlement for $16,835 subject to attorneys' fees and costs. The trustee testified that this was his first notice of the lawsuit. The trustee had the bankruptcy case re-opened to administer the settlement proceeds. The trustee took the position that the settlement proceeds could not be exempted because the debtor failed to disclose the lawsuit during the original administration of the bankruptcy case and made no effort to report it afterward until the bankruptcy trustee found out about it.

In October 2006 the bankruptcy court approved a settlement between the trustee and the manufacturer of fen-phen for $16,835 less costs of $1,910 and attorneys' fees of 40%. The trustee received a settlement payment of $7,614.65 in December 2006, and the remainder should be received within six months. Shortly after approval of the settlement, the debtor amended the schedules to list the lawsuit as an asset and apparently to claim the proceeds as exempt. The value of the asset was listed as unknown, and zero was given as the amount of

the claimed exemption. A few weeks later the trustee filed an objection to the exemption claim. About a month after that, in late November 2006, the debtor amended the schedules again to list the value of the lawsuit and the amount of the claimed exemption as $7,711.00.

The debtor could have exempted almost all the net proceeds if she had disclosed the class action claim when she filed her bankruptcy case and claimed the exemption. Tenn. Code Ann. § 26-2-111(2)(B) ($7,500 exemption). Concealing the class action claim to protect it from bankruptcy did not make sense, but this is often true when a debtor in bankruptcy conceals exemptible property. The debtor's intent may still be dishonest and result in loss of the exemption. Thus, the debtor's lack of a good legal reason for concealing the class action claim reveals little or nothing about her intent – about whether she honesty or dishonestly failed to disclose the claim.

The debtor testified as to why she failed to disclose the lawsuit. According to the trustee, the debtor remembered the lawsuit because she was receiving regular status reports from the lawyers, but she did not disclose it because she did not know whether she would ever receive anything from it. In other words, the trustee interprets the debtor's testimony to mean that she thought about the lawsuit when she filed the bankruptcy case but chose not to disclose it because she thought it was probably worthless.

This interpretation of the debtor's testimony is doubtful. The debtor did not testify that the regular status reports caused her to remember the class action claim when she was providing information to her lawyer for filing the bankruptcy case or at any time during the bankruptcy case. The trustee seems to be arguing that since the debtor received periodic reminders from the lawyers, then she must have remembered the class action claim or the court should not believe she forgot it.

The debtor testified, in effect, that she did not think about the lawsuit when she filed

her bankruptcy case — she forgot it — because she did not expect to receive anything from it. The court can understand this. Unless a person is fairly sure of proving a much larger amount of damages than most plaintiffs in a class action, then joining with thousands of other plaintiffs is like entering a sweepstakes with a small potential payoff. After joining, the only significant notice is the one saying whether you have won anything. The slim prospect of receiving a large reward makes it easy to put the class action out of mind. *Compare In re Colvin*, 288 B.R. 477 (Bankr. E. D. Mich. 2003). Semi-annual notices that the lawsuit is grinding along are not likely to make it something that will easily come to mind when the plaintiff is asked to list all assets. *Compare In re Barber*, 223 B.R. 830 (Bankr. N. D. Ga. 1998). Thus, the court concludes that the debtor forgot about the class action claim when she filed bankruptcy and during the bankruptcy case because it did not stick in her mind as anything of value. Honestly forgetting is not dishonest concealment and does not justify denial of the exemption.

For the purpose of argument, however, suppose the trustee is correct about the debtor's reason for not disclosing the class action claim. According to the trustee, the debtor specifically remembered the class action claim when she filed the bankruptcy case, but she chose not to disclose it because she thought it was worthless. Is that the kind of intent to conceal the claim that would prevent the debtor from exempting it? Perhaps. The debtor in a bankruptcy case is supposed to disclose all assets, even those the debtor thinks to be worthless. An honest debtor's decision not to disclose a supposedly worthless claim for damages makes sense if the debtor has good reasons for being almost certain the claim is worthless. Simple uncertainty as to the value of a claim should spur the debtor to disclose it, not omit it. Nevertheless, the question of intent in that situation is close. The court might find it difficult to say that the debtor had a fraudulent or dishonest reason for not disclosing the supposedly worthless claim for damages. The decision should turn on the debtor's credibility,

especially with regard to the debtor's understanding of the obligation to disclose all assets in the bankruptcy case. The court postpones a decision on this question until after considering the debtor's later failure to disclose the claim when she received notice of the proposed settlement after her bankruptcy. The debtor's actions after receiving the settlement notice reflect on her intent when she filed the bankruptcy case and during the case.

The trustee asks the court to infer bad faith from the debtor's failure to disclose the claim when she received notice of the proposed settlement after the bankruptcy case was closed. The debtor revealed the bankruptcy to the lawyers in the class action by honestly answering the questionnaire they sent. If the debtor had intended from the very beginning of the bankruptcy case to conceal the class action claim from the bankruptcy trustee and creditors, surely she had the cunning to know that the closed bankruptcy case should not be revealed to the class action lawyers.

The trustee might argue that the debtor revealed the bankruptcy case to the class action lawyers only because she was afraid of losing the settlement money. In this regard, the debtor could have thought that revealing the bankruptcy would make no difference to whether she received the money, or she could have feared that the class action lawyers would find out about the bankruptcy by other means, and that would make a difference to whether she received the money. Indeed, the problem faced by the debtor should have been obvious. She had failed to disclose the pending class action claim in her bankruptcy case, and after completing the bankruptcy case, she received notice of a large settlement. How could the debtor *not* realize that failure to disclose the lawsuit in the bankruptcy case created a problem with receiving the settlement?

Having heard the debtor's testimony and observed her demeanor, the court concludes that the debtor was never thinking of ways to conceal the class action claim from the

bankruptcy trustee or creditors. She did not think about the claim immediately before or during the bankruptcy case. When she received notice of the proposed settlement after bankruptcy, she was not struck with the idea that failure to disclose the claim in the bankruptcy case caused a problem with receiving the settlement or the idea that she should disclose the proposed settlement to the bankruptcy trustee or her bankruptcy lawyer even though the bankruptcy case was closed. If the debtor was knowingly trying to conceal the class action claim so that it would be protected from the effects of her bankruptcy, she needed only low cunning or sharp thinking to realize that she should not reveal the bankruptcy to the class action lawyers. But she did reveal the bankruptcy. The court concludes that the debtor was not acting in bad faith when she failed to disclose the class action claim after receiving notice of the proposed settlement.

This result doubtlessly seems odd because many, if not most, debtors would have realized that accepting the settlement proceeds was legally and ethically questionable since the lawsuit had not been disclosed in the bankruptcy case. *In re Keith*, 336 B.R. 746 (Bankr. W. D. Ky. 2006). But the question for the court is whether this particular debtor had the bad faith intent to conceal the class action claim from creditors or the bankruptcy trustee. The debtor failed to see that her failure to disclose the claim in the bankruptcy case caused a problem with receiving the settlement proceeds, and then she revealed the bankruptcy to the class action lawyers. The debtor's actions reveal both a lack of understanding and a lack of dishonest intent. Debtors can often be bewildered or at least very confused when it comes to bankruptcy. They fail to understand not only the effect of the bankruptcy on their rights and liabilities but also their duties in the bankruptcy case. They can miss points that are obvious to others and may be obvious to them in retrospect or after some explanation. *Ford v. Gillman (In re Ford)*, 336 B.R. 813 (10th Cir. B.A.P. 2006); *In re McVay*, 345 B.R. 846 (Bankr. N. D. Ohio 2006); *Sheehan v. Lincoln Nat. Life*, 257 B.R. 449 (N. D. W. Va. 2001). The debtor appears to have been afflicted with this lack

of understanding. She did not act in bad faith when she failed to disclose the class action claim or the proposed settlement to the bankruptcy trustee or her bankruptcy lawyer.

This brings the court back to the question it reserved earlier. For the purpose of argument, the court assumes that the debtor remembered the class action claim when she filed bankruptcy or during the original administration of the case, but she did not disclose it because she thought it was practically worthless. Did this decision amount to a bad faith attempt to protect the claim from the effect of bankruptcy? The answer depends primarily on the debtor's credibility, especially with regard to her understanding of her duty to reveal all assets in the bankruptcy case. The court's earlier reasoning leads to the conclusion that the debtor did not act in bad faith when she failed to disclose the claim.

The court may also deny an exemption if the debtor disdained the duty to give an honest accounting of assets. *In re McKain*, 325 B.R. 842 (Bankr. D. Neb. 2005). The evidence fails to show that the debtor was unconcerned with honestly disclosing all her assets.

For the purpose of deciding whether to allow a late exemption claim, the courts have also considered prejudice to the bankruptcy estate or the bankruptcy trustee. *In re Cudeyro,* 213 B.R. 910 (Bankr. E. D. Pa. 1997). Allowing the debtor's late claim of the exemption does not take money away from the bankruptcy estate because the exemption would have been allowed if the debtor had disclosed the property earlier. On the other hand, the debtor's failure to disclose the property and claim the exemption early in the case justified the trustee's actions. The debtor's lack of diligence in carrying out her obligations under bankruptcy law caused prejudice to the bankruptcy estate in the form of expenses incurred by the trustee in having the bankruptcy case re-opened, settling the class action claim, and pursuing the objection to the exemption. The trustee has not requested collection of expenses from the settlement proceeds or the debtor, but other courts have allowed it in similar situations. *Arnold v. Gill (In re Arnold),*

252 B.R. 778 (9th Cir. B.A.P. 2000)*; In re Fournier,* 169 B.R. 282 (Bankr. D. Conn. 1994)*; In re Stewart,* 11 B.R. 447 (Bankr. N. D. Ga. 1981)*; see also Latman v. Burdette,* 366 F.3d 774 (9th Cir. 2004). The court will allow the trustee time to request payment of expenses before ordering him to disburse the settlement proceeds to the debtor.

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