UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF RHODE ISLAND
- - - - - - - - - - - - - - - - - - -x

In re: :

TAMI L. VARELA : BK No. 02-13788
Debtor Chapter 7

- - - - - - - - - - - - - - - - - - -x

ORDER

APPEARANCES:

James T. Marasco, Esq.
Attorney for Debtor
617 Smith Street
Providence, Rhode Island 02903

Marc D. Wallick, Esq.
Chapter 7 Trustee
WALLICK & PAOLINO
51 Jefferson Boulevard
Warwick, Rhode Island 02888

BEFORE ARTHUR N. VOTOLATO, United States Bankruptcy Judge

Heard on the Chapter 7 Trustee's Application to Compromise, for $10,500, a claim for personal injuries sustained by the Debtor, and the Debtor's Motion to Amend Schedules B and C to claim as exempt 100% of the net settlement proceeds. The bizarre scenario described below begins and ends with the Debtor's objection to a proposed compromise, filed by her bankruptcy lawyer, who also serves as special counsel to the Trustee, and who obtained the settlement offer in question. For the reasons discussed below, as well as the facts, the applicable law, and the entire case record, the Debtor's motion to Amend Schedule C is DENIED, her objection to the Trustee's Application to Compromise is OVERRULED, and the proposed compromise is APPROVED.

BACKGROUND

On September 28, 2002, Tami L. Varela was injured in an automobile accident. A few days later Varela filed a Chapter 7 petition and Marc D. Wallick, Esq. was appointed as Chapter 7 Trustee. The original petition and schedules make no reference to a claim for personal injuries,[1] but at the Section 341 meeting

[1] In fairness to the Debtor regarding potential issues of concealment and false oath, the signature page of the petition

of creditors, under questioning by the Trustee, the Debtor revealed the facts of the accident and the details of her injuries. Subsequent to the disclosures obtained at the § 341 meeting, the Debtor amended Schedules B and C to state: ”Debtor was involved in a hit and run accident on 9/28/02. She is pursuing a claim again[st] GEICO Insurance Company under the uninsured motorist coverage.” The claim was valued at $21,000. On her Amended Schedule C, Varela claimed the following exemptions in the personal injury action: “11 USC §522(d)(5) $3,575... 11 USC §522(d)(11)(D) $17,425.” In the absence of any objection, the amendments were allowed by rule of court.

Thereafter, without conditions or limitations, the Trustee hired James Marasco, Esq., Debtor’s bankruptcy counsel, to prosecute the personal injury claim on behalf of the estate. As Trustee’s counsel, Marasco obtained a settlement offer of $10,500, and submitted said offer to the Trustee, who filed an application to compromise the claim for that sum. A few days later, this time wearing his Debtor’s counsel hat, Marasco filed

---

bears the date September 18, 2002, ten days before the accident. This does not, however, relieve the Debtor or her attorney of their joint obligation to be sure that the petition and schedules are accurate as of the day of filing.

a second motion to amend Schedules B and C, setting the value of the claim at $10,500, claiming one exemption under Section 522(d)(5) in the amount of $9,637.50. After moving to amend schedules on behalf of the Debtor, Marasco objected to the very settlement he had negotiated and recommended as counsel for the Trustee.

DISCUSSION

The Trustee argues correctly that on these facts it is far too late for the Debtor to object to the settlement, and then to amend the exemption claim in order to scoop up all the proceeds of the personal injury complaint action. Initially, the Debtor claimed and was entitled to $3,575 under Section 522(d)(5), and nothing under d(11)(D), since her injuries were not alleged to be permanent. The Debtor is required to show under Section 522(d)(11)(D) that the claimed exemption represents compensation for permanent injuries.[2] *In re Gregoire*, 210 B.R. 432, 436

[2] In *Gregoire* we stated that Section 522(d)(11)(D) is limited to payments made specifically to compensate for permanent injuries suffered by the debtor, *see In re Marcus*, 172 B.R. 502 (Bankr. D. Conn. 1994), and while the Trustee has the burden of proving that exemptions are not properly claimed, the initial burden is with the Debtor to

(Bankr. D.R.I. 1997). The parties agree that the Debtor suffered no permanent injury, and this likely explains why the Debtor now wants to pigeonhole her latest exemption into 522(d)(5).[3]

Federal Rule of Bankruptcy Procedure 1009(a) allows a debtor to amend his/her schedules "as a matter of course at any time before the case is closed," and it is clear that requests for leave to amend are to be treated liberally in the Debtor's favor. However, "[t]here are two established exceptions to a debtor's right to amend schedules: a bankruptcy court has the discretion to deny an amendment to schedules based upon a showing of either: (1) prejudice to creditors or third parties; or (2) bad faith." *In re Wood*, 291 B.R. 219, 228 (B.A.P. 1st Cir. 2003).

> establish that the exemption, as claimed, is of the type covered by the statute. Fed. R. Bankr. P. 4003(c).

In re Gregoire, 210 B.R. 432, 436 (Bankr. D.R.I. 1997).

[3] Section 522(d)(5) allows as exempt: "The debtor's aggregate interest in any property, not to exceed in value $800 plus up to $7,500 of any unused amount of the exemption provided under paragraph (1) of this subsection."

In order to prevail here, the trustee need not show prejudice to the estate or the entire creditor body. Rather, prejudice to the trustee or a single creditor is sufficient to defeat a motion to amend. *See Snyder v. Rockland Trust Co.* (*In re Snyder*), 279 B.R. 1, 6 (B.A.P. 1st Cir. 2002). Merely establishing prejudice, however, does not end the inquiry. The Court must also weigh the prejudice to the Debtor if the exemption is disallowed, against the prejudice to third parties in allowing the exemption. *See Arnold v. Gill* (*In re Arnold*), 252 B.R. 778, 785 (B.A.P. 9th Cir. 2000).

In reliance on the sworn schedules and the exemptions as originally claimed, and based on the Debtor's own description of her injuries, i.e., *not permanent*, the Trustee took over the personal injury claim, hired special counsel, and invested considerable effort and many months in prosecuting the claim.

The Trustee's present request is to compromise a claim which is the only asset in this estate. If the proposed amendment and claimed exemption are allowed, the Debtor will receive the entire settlement proceeds, causing the Trustee (and creditors) financial loss, and the Trustee will have expended time and

expense in reliance on the Debtor's actions and posturing. *See In re Blaise*, 116 B.R. 398 (Bankr. D. Vt. 1990).

Except for the conflict of interest that he unwittingly created by hiring Mr. Marasco as his special counsel, the equities here are all with the Trustee.

> There is great unfairness in having a trustee diligently take charge of assets not claimed as exempt and reduce the asset to cash, expending considerable time, effort and expense in the process. Then, when the case would be otherwise distributed to the creditors, the debtor seeks to amend his exemptions to claim the benefits of the trustee's work, without bearing the burden of the trustee's efforts.

In re Selman, 7 B.R. 889, 890 (Bankr. N.M. 1980).

In balancing the relative prejudice as between the Debtor and the Trustee (i.e., the estate), I find that allowing the Debtor to amend her exemption claim in these circumstances would unfairly prejudice the Trustee and creditors. I also find that there is present throughout this case a general pattern of conduct which, cumulatively, amounts to a lack of good faith. Accordingly, the Motion to Amend Schedule C is DENIED, the Motion to Amend Schedule B is GRANTED, and the Application to Compromise is APPROVED, as there is no substantive objection to

the compromise as proposed.[4] Because it does not appear that the Debtor orchestrated the questionable tactics discussed herein, she is allowed her exemption as originally claimed, in the amount of $3,575. The balance of the settlement proceeds are property of the estate.

This case illustrates the inevitable aftermath when professionals wear two hats. Here, the problem surfaced when Marasco continued to serve as counsel for both the Trustee and the Debtor, *after the settlement was reached*, and is highlighted by Marasco's objection to the very settlement he obtained, on the ground that it is disadvantageous to *one* of his clients, i.e., the Debtor.[5] The fact that neither the Trustee nor Mr. Marasco acknowledge the conflict is more disturbing than the conflict itself. How blatant or egregious must it get before the Court should step in and prevent such occurrences? *See* R.I.

---

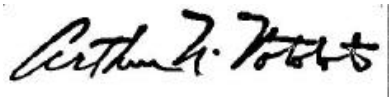
[4] The only conceivable motive for filing the objection to compromise is the creation of leverage by the Debtor regarding her motion to amend her exemption claim – an ethically questionable move, at best.

[5] While still counsel of record for both the Debtor and the Trustee, Mr. Marasco elected (without notice) to abandon his "other client," the Trustee, and to pledge his allegiance to the Debtor.

Rule of Prof'l Conduct R. 1.7. Having asked that rhetorical question, the issue need not be addressed further at this time, but will be more appropriately considered at the hearing on fee applications.

Enter judgment consistent with this Order.

Dated at Providence, Rhode Island, this 21st day of December, 2004.



Arthur N. Votolato
U.S. Bankruptcy Judge

Entered on docket: 12/21/04