

# I. Introduction

Debtors filed for bankruptcy under Chapter 7 to obtain a fresh start while maintaining ownership of their family home and several other possessions. Debtors listed their home in Show Low, Arizona, an inherited IRA, and six months of food fuel and provisions as exempt property. As a result of counsel's failure to file a timely response to Trustee's objections to these claimed exemptions, Debtors are faced with the possibility of losing their home and other personal property which they may be entitled to claim as exempt. Debtors' counsel has filed a motion to alter or amend the judgment sustaining Trustee's objections, or, in the alternative, to set aside the judgment. Because the Court finds that Debtors have carried their burden of showing excusable neglect, and because the Court would prefer to determine the validity of the exemptions on the merits before stripping Debtors of some of their most valuable remaining possessions, Debtors' motion to set aside the judgment will be granted. Therefore, the Court need not consider Debtors' motion to alter or amend the judgment.

## II. Facts

2 On April 7, 2010, Debtors filed a joint bankruptcy petition, seeking relief under Chapter 3 7 of the Bankruptcy Code. Concurrent with their petition, Debtors filed their schedules of assets 4 and liabilities. Debtors' Schedule A indicated ownership of two pieces of real property, a single 5 family home located at 19124 E. Cloud Road, Queen Creek, AZ 85142, and a mobile home and lot located at 4614 Larkspur Road, Show Low, AZ 85901 (Show Low Property). Debtors' 6 7 Schedule C listed the Show Low Property as exempt under Ariz. Rev. Stat. § 33-1101, Arizona's 8 homestead exemption. Schedule C also listed exemptions for two pieces of personal property relevant to this dispute, a \$1,000 exemption for six months of food, fuel and provisions under Ariz. Rev. State. § 33-1124 and an inherited IRA owned by co-debtor Sherrie Harter, worth \$87,878.66, claimed exempt under Ariz. Rev. Stat. § 33-1126(B).

On June 22, 2010, Debtors' Chapter 7 Trustee filed an Objection to Exemptions and Notice of Bar Date (Objection). Trustee objected to Debtors' assertion of exemptions of the Show Low Property, and \$1,000 in food, fuel and provisions. The Objection stated that Debtors had not yet provided information requested by Trustee which would allow a determination of the propriety of the claimed exemptions. Additionally, the Objection claimed that Trustee required specification of what food, fuel and provisions Debtors claimed as exempt because "courts have disallowed the exemption of gift cards and other pre-paid accounts...." As a result, Trustee objected to the exemptions until the required information was provided. However, no affirmative argument was made regarding why the exemptions should be disallowed.

Trustee amended the Objection on June 24, 2010 (Amended Objection) and July 26, 2010
(Second Amended Objection). The Amended Objection added information about an alleged
undisclosed prepetition transfer of the Show Low Property to a third party for no consideration.
Trustee argued that this transfer foreclosed exemption of the property. The Second Amended
Objection added an objection to Debtors' exemption of the inherited IRA owned by Ms. Harter.
Trustee simply argued "[i]nherited IRA accounts are not exempt," and cited several bankruptcy

court decisions concluding that inherited IRA accounts are not exempt under various state law
 exemption statutes.

Debtors failed to respond to any of Trustee's objections and on August 30, 2010, Trustee docketed a certificate of service and no objections, as well as a proposed order sustaining the objections raised in his Second Amended Objection. The Court signed the order sustaining Trustee's objections (Order) later that day.

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## A. Motion for Reconsideration

Four days after the Court entered the Order, on September 3, 2010, Debtors filed a motion for reconsideration or to alter or amend the judgment under Fed. R. Civ. P. 59(e)<sup>1</sup> (Reconsideration Motion). In the Reconsideration Motion, Debtors argue that no legal or factual basis existed for sustaining Trustee's objections and that the Order should not have been entered.

With regard to the homestead exemption, Debtors claim that the only case cited by Trustee to support his objection was clearly inapposite and that Trustee failed to allege any other facts or law supporting his objection. Instead, Trustee simply stated that he objected because he was conducting an investigation into the propriety of the claimed exemptions. Debtors claim a similar deficiency in Trustee's objection to the exemption of food, fuel and provisions, which simply stated that more information was required to determine the validity of the claimed exemptions.

Debtors also argue that the cases cited by Trustee in support of his objection to exemption of Ms. Harter's inherited IRA were not on point. Each of the cases, except one, which did not address exemptions, dealt with state law exemption statutes with language different from the Arizona statute. Further, Debtors claim that case law indicates that the inherited IRA is

<sup>1</sup> Fed. R. Bankr. P. 9023 makes Fed. R. Civ. P. 59 applicable in bankruptcy cases.

exempt under Bankruptcy Code §§ 522(b)(3)(C) and (b)(4),<sup>2</sup> which were added by BAPCPA
 and exempt tax-free retirement funds even in states that opt-out of the federal exemption scheme.

3 At the November 16, 2010 Reconsideration Motion hearing, in addition to reiterating arguments made in their motion, Debtors also explained that they had failed to respond to 4 5 Trustee's objections because Debtors were in the process of switching counsel and, as a result, 6 neither prior counsel nor new counsel was aware that the other had failed to respond. Trustee 7 raised a concern that what Debtors were actually seeking at the hearing was relief from the Order 8 under Fed. R. Civ. P.  $60(b)^3$  due to counsel's alleged excusable neglect, but that Debtors had not 9 provided any reason in their motion why they did not respond to Trustee's objection, and had 10 made a motion under Rule 59, not Rule 60(b).

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# *B. Motion for Relief from the Order*

In response to the concerns raised at the November 16 hearing, Debtors filed a motion for 12 13 relief from the Order (Rule 60(b) Motion) on December 3, 2010. The Rule 60(b) Motion 14 reiterated Debtors' belief that Trustee had not provided sufficient factual or legal support to 15 carry his burden of proving, under Rule 4003(c), that the exemptions were not properly taken. 16 Debtors also raised several new arguments, including alleged procedural deficiencies and an argument that Debtors were negotiating in good faith and providing the information requested by 17 Trustee, and were under the impression that Trustee would not seek entry of an order sustaining 18 19 the objections until Debtors were notified that the documentation provided was insufficient. This 20 reliance, Debtors claim, constitutes the type of mistake, surprise or excusable neglect required to 21 set aside the Order under Rule 60(b).

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 <sup>&</sup>lt;sup>2</sup> Debtors argue in their Reconsideration Motion that the inherited IRA is exempt under both Arizona law and Federal law. However, Debtors' Schedule C lists the exemption under Arizona law only. The Court will consider Debtors' Schedule C to be amended in accordance with the claims made in their Reconsideration Motion,

see In re Weilhammer, 2010 WL 3431465 (Bankr. S.D. Cal. Aug. 30, 2010), but Debtors will be required to formally amend their schedules within 14 days of the entry of this decision to indicate that an exemption is claimed under §
 522(b)(3)(C). If Debtors fail to amend their schedules within 14 days of the date on this decision, Debtors' exemption on the inherited IRA will be limited to Arizona state law.

<sup>27 &</sup>lt;sup>3</sup> Fed. R. Bankr. P. 9024 makes Fed. R. Civ. P. 60 applicable in bankruptcy cases.

#### III. Analysis

2 When a party seeks relief from a default judgment on the grounds of excusable neglect, 3 three factors inform the Court's exercise of discretion: (1) whether the defendant's culpable 4 conduct led to the default; (2) whether the defendant has a meritorious defense; and (3) whether 5 reopening the default judgment would prejudice the plaintiff. Employee Painters' Trust v. Ethan Enters., Inc., 480 F.3d 993, 1000 (9th Cir. 2007). The Court must consider these factors in light 6 7 of several guiding policies. First, Rule 60(b), as a remedial rule, must be liberally applied. In re 8 Hammer, 940 F.2d 524, 525 (9th Cir. 1991). Second, as a general rule, default judgments are 9 disfavored, and cases should be decided on the merits when reasonably possible. *Westchester* 10 Fire Ins. Co. v. Mendez, 585 F.3d 1183, 1189 (9th Cir. 2009). In other words, where judgment 11 has been entered upon default, interests in finality should give way "fairly readily" to the competing interest in determining issues on the merits. TCI Group Life Ins. Plan v. 12 Knoebber, 244 F.3d 691, 696 (9th Cir. 2001). And finally, when a party properly seeks relief from a default judgment, doubt, if any, should be resolved in favor of the motion to set aside the judgment. In re Hammer, 940 F.2d at 525.

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### А. Culpable Conduct

According to the Ninth Circuit, culpable conduct exists, for purposes of a Rule 60(b) analysis involving a default judgment, where there is "no explanation of the default inconsistent with a devious, deliberate, willful, or bad faith failure to respond." Employee Painters' Trust v. Ethan Enters., Inc., 480 F.3d at 1000 (quoting TCI, 244 F.3d at 698). An expeditious motion to amend or set aside a judgment may indicate good faith. See Pinson v. Equifax Credit Info. Servs., Inc., 316 Fed. Appx. 744, 750 (10th Cir. 2009) (defendant's good faith evidenced by filing of motion to set aside six days after entry of judgment).

In this case, there is no indication of culpable conduct on the part of Debtors or their counsel. Counsel had been in discussions with Trustee regarding documentation required to substantiate the claimed exemptions. Until one week prior to the entry of the Order, counsel had

been providing documents requested by Trustee. No evidence exists suggesting that Debtors
were refusing to provide substantiating documentation, or were otherwise attempting to delay
Trustee in bad faith. To the contrary, the ongoing discussions and disclosure between the parties
indicates good faith and a belief that the parties could reach a consensual resolution of the
objections without the need for Court intervention. Though counsel's assumption that Trustee
would not seek default judgment may have been ill-advised, especially in the absence of a
written agreement, counsel's actions certainly do not indicate a "devious, deliberate, willful, or
bad faith" motive.

Likewise, Debtors' quick response to the entry of the Order indicates good faith. *See Pinson*, 316 Fed. Appx. at 750. Debtors filed the Reconsideration Motion just four days after entry of the Order. Although the Rule 60(b) Motion was not filed until several months later, the expeditious filing of the Reconsideration Motion indicates that Debtors truly were caught off guard. The Court concludes default entry of the order sustaining Trustee's objections did not result from the culpable conduct of Debtors or their counsel.

## B. Prejudice

A party seeking relief from a default judgment must also show a lack of prejudice to the non-moving party. Prejudice to the non-moving party requires more than a simple delay in resolution of the case. *United States v. Signed Personal Check No. 730 of Yubran S. Mesle*, 615 F.3d 1085, 1095 (9th Cir. 2010). Rather, "the standard is whether [plaintiff's] ability to pursue his claim will be hindered." *TCI*, 244 F.3d at 701 (citing *Falk v. Allen*, 739 F.2d 461, 463 (9th Cir. 1984)); *see Thompson v. Am. Home Assurance Co.*, 95 F.3d 429, 433-34 (6th Cir. 1996) (to be considered prejudicial, "the delay must result in tangible harm such as loss of evidence, increased difficulties of discovery, or greater opportunity for fraud or collusion").

Trustee in this case has not suggested that any prejudice would result from setting aside the Order. Trustee simply argues that Debtors missed their time to object, and they should not be given a second bite at the apple. For their part, Debtors point out that the Reconsideration

Motion was filed four days after entry of the Order, that they continued to provide 1 2 documentation until one week before entry of the order, and Debtors' counsel continued to 3 cooperate with Trustee's requests for information. Debtors' cooperation indicates that there may 4 be a *greater* opportunity for discovery. Aside from delay in the resolution of the Second 5 Amended Objection, the Court finds that Trustee will not suffer any tangible harm. No evidence will be lost and it is likely that Trustee will be able to gather more information, more easily 6 7 regarding the claimed exemptions. As a result, the Court concludes that no prejudice to Trustee 8 exists in this case.

### С.

## Meritorious Defense

In addition to showing lack of culpable conduct and an absence of prejudice to the opposing party, Debtors must also prove the existence of a meritorious defense. *Employee Painters' Trust*, 480 F.3d at 1000. "[T]he burden on a party seeking to vacate a default judgment is not extraordinarily heavy." *Signed Personal Check No.* 730, 615 F.3d at 1094 (quoting *TCI*, 244 F.3d at 700). To satisfy the criterion of a "meritorious defense," the defense need not be ultimately persuasive at this stage. *Am. Alliance Ins. Co., Ltd. v. Eagle Ins. Co.*, 92 F.3d 57, 61 (2d Cir. 1996). Instead, Debtors must simply show that there is some possibility that the outcome, after a full trial, will be contrary to the result upon default. *Haw. Carpenters' Trust Funds v. Stone*, 794 F.2d 508, 513 (9th Cir. 1986). In making its determination, the Court must take facts presented by the movant as true. *Signed Personal Check No.* 730, 615 F.3d at 1094.

# i <u>Homestead</u>

Debtors first contend that Trustee's objection to exemption of the Show Low Property should not have been sustained because Trustee failed to present an objection that was sufficient on its face. Debtors point out that according to Fed. R. Bankr. P. 4003(c), the objecting party has the burden of proving that an exemption is not properly taken. Debtors contend that Trustee failed to meet his burden by failing to set forth specific facts requiring disallowance of the claimed homestead exemption. According to Debtors, Trustee's mere assertion that he was

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investigating the propriety of the homestead exemption was not sufficient to prove that Debtors were not entitled to the exemption, especially in light of recently provided water bills, which they claim show that they were residing at the Show Low Property at the time of their petition.

Trustee, likewise, indicated at the Reconsideration Motion hearing that he had obtained utility bills indicating that Debtors did *not* reside at the Show Low Property. Because the Court did not hear the issue on the merits, it did not have the opportunity to make a factual determination as to whether Debtors were residing at the Show Low Property. In light of the utility bills recently provided by Debtors, indicating that Debtors were residing at the Show Low Property, Debtors have met their burden of showing some possibility that the outcome will be contrary to the result upon default. *Haw. Carpenters' Trust Funds v. Stone*, 794 F.2d at 513.

IOf course, Debtors factual allegations cannot overcome binding Ninth Circuit case lawWhich would disallow the exemptions as a matter of law. In his Second Amended Objection,Trustee alleged Debtors had made a prepetition transfer of property to a third party withoutconsideration, and as a result, *In re Glass*, 60 F.3d 565 (9th Cir. 1995) prevents Debtors fromexempting the property. Debtors admit that they transferred the property, but claim that becausethe property was transferred back to them prepetition, *In re Glass* is inapplicable. *See Glass*, 60F.3d at 567 (agreeing with B.A.P. decision requiring a showing that "debtor transferred propertyin such a manner as to invoke the trustee's avoidance powers under §§ 510(c)(2), 542, 543, 550,551 or 553, the transfer was voluntary or the debtor knowingly concealed the transfer or aninterest in the property, and the property was returned to the estate as a result of the trustee'sefforts, not limited to actions directed toward the transferee."). No evidence has been presentedregarding the prepetition transfer, or whether the requirements of *In re Glass* have been met.However, the facts set forth by Debtors, which must be taken as true for purposes of the Rule60(b) Motion, *see Signed Personal Check No. 730*, 615 F.3d at 1094, could change the result onthis issue if it is shown that the transfer back to Debtors was not the result of Trustee's efforts.

While the Court is not making a determination regarding Debtors' entitlement to the
 claimed homestead exemption, the Court finds that Debtors have provided sufficient factual and
 legal arguments to show that there is a possibility that Debtors may succeed in defending against
 Trustee's objection on the merits. Debtors have met their burden of showing a meritorious
 defense to Trustee's homestead exemption objection. As a result, Debtors' Rule 60(b) Motion
 will be granted as to the claimed homestead exemption.

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## ii <u>Six months of Food, Fuel & Provisions</u>

8 Debtors argue that, as with the homestead exemption, Trustee failed to meet his burden 9 of showing that Debtors were not entitled to the claimed exemption of the six months in food, 10 fuel and provisions under A.R.S. § 33-1124. The Second Amended Objection suggests only that 11 Debtors may not be entitled to their exemption of six months of food, fuel and provisions because courts have disallowed exemption of gift cards and other pre-paid accounts. However, 12 13 Trustee made no affirmative assertion that the food, fuel and provisions that Debtors were 14 exempting were gift cards or other pre-paid accounts. Debtors assert, in their Rule 60(b) Motion, 15 that the exemption is for a propane tank for heating and cooking, food for dogs and horses, and food in Debtors' pantry. Debtors have asserted facts, which, if proven, would constitute a defense. See Signed Personal Check No. 730, 615 F.3d at 1094. The Court will grant Debtors' Rule 60(b) Motion to allow a determination of the validity of the exemption on the merits.

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# ii <u>Inherited IRA</u>

Debtors last argue that Trustee's objection to the exemption of Ms. Harter's inherited IRA lacked legal support sufficient to carry Trustee's burden. Debtors point out that none of the cases cited by Trustee in his Second Amended Objection considered whether inherited IRAs are exempt under Arizona law, or whether they are exempt under federal law as amended by BAPCPA. *See* 11 U.S.C. §§ 522(b)(3)(C)- (b)(4). In his response to the Reconsideration Motion, Trustee cites an unpublished case finding that inherited IRAs are not exempt under Arizona state law. Likewise, Trustee argues that *In re Chilton*, 426 B.R. 612 (Bankr. E.D. Tex 2010) precludes exemption of inherited IRAs under the federal exemptions. Debtors point out, however, that
 other courts, including the courts in *In re Tabor*, 433 B.R. 469 (Bankr. M.D. Pa. 2010) and *In re Nessa*, 426 B.R. 312 (B.A.P. 8th Cir. 2010) have concluded that inherited IRAs are indeed
 exempt under § 522(b)(3)(C).

The Court has not considered whether inherited IRAs are exempt under § 522(b)(3)(C). However, the Court notes that a growing number of decisions exist, including a recent decision in this district, which conclude that inherited IRAs are exempt under the federal statute as amended by BAPCPA. *See In re Thiem*, 2011 WL 182884 (Bankr. D. Ariz. Jan. 19, 2011); *see also In re Weilhammer*, 2010 WL 3431465 (Bankr. S.D. Cal. Aug. 30, 2010). Therefore, the Court finds that Debtors have raised a defense which could result in a favorable outcome on the merits and will grant Debtors' Rule 60(b) Motion as to the inherited IRA exemption.

# IV. Conclusion

The Court has concluded that Debtors' Rule 60(b) Motion should be granted so that the propriety of Debtors' claimed exemptions may be determined on the merits. This is consistent with the policy favoring determination of issues on the merits and disfavoring default judgments. Debtors have shown that entry the Order was not a result of their culpable conduct. Nor will Trustee be prejudiced by granting the Rule 60(b) Motion. Further, Debtors have met their burden of raising meritorious defenses to each of the exemptions objected to by Trustee. The Rule 60(b) Motion will be granted in its entirety. Because the Court will grant the Rule 60(b) Motion, the Reconsideration Motion is moot.

Debtors are to upload a form of order. Debtor shall file an amended Schedule C within 14 days and the trustee shall have 14 days thereafter to file an amended objection with the Court setting out a prima facie case for each exemption to which he seeks to object.

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| 3  | <b>DATED</b> : March 15, 2011   |
| 4  | Manuf Care  |
| 5  | CHARLES G. ASE II   |
| 6  | UNITED STAKES BANKRUPTCY JUDGE  |
| 7  | <b>COPY</b> of the foregoing mailed by the BNC and/or                                 |
| 8  | sent by auto-generated mail to:   |
| 9  | Rickie Ballard and Sherrie Harter<br>P.O. Box 1262                                    |
| 10 | Show Low, AZ 85902<br>Debtors   |
| 11 | Keith Knowlton  |
| 12 | 9920 S. Rural Road, Suite 108<br>PMB # 117  |
| 13 | Tempe, AZ 85284<br>Debtors' Counsel   |
| 14 |   |
| 15 | Lawrence Warfield<br>P.O. Box 14647<br>Societadala A.7.852(7)                         |
| 16 | Scottsdale, AZ 85267<br>Chapter 7 Trustee   |
| 17 | Terry Dake  |
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| 19 | Chapter 7 Trustee's Counsel   |
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