

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re:

CASE NO. 97-23388

FRANK H. WADSWORTH and
VANETTE E. WADSWORTH (d/b/a
Wadsworth Service Station,
f/d/b/a Wadsworth Garden Center),

Debtors.

DECISION & ORDER

BACKGROUND

On September 9, 1997, Frank H. and Vanette E. Wadsworth (the "Debtors") filed a petition initiating a Chapter 7 case. On the Schedules and Statements required to be filed by Section 521 and Rule 1007, the Debtors: (1) scheduled as an asset a Metropolitan Insurance Company Annuity (the "Annuity"), payable to Frank M. Wadsworth in connection with the settlement of a 1986 automobile accident, which provided for a \$30,000.00 payment on July 3, 1998 and a \$50,000.00 payment on July 3, 2003; (2) claimed the Annuity as exempt property; and (3) scheduled J.O. Cook, Inc. ("Cook") as an unsecured creditor with a claim of \$43,282.86.

After the Office of the United States Trustee appointed Douglas J. Lustig, Esq. as the Debtor's Chapter 7 Trustee (the "Trustee"), an October 7, 1997 Notice of a Section 341 Meeting of Creditors was mailed to all creditors, including Cook. The

BK. 97-23388

Notice indicated that the Debtors' case was currently being administered as a no asset case and instructed creditors not to file a proof of claim unless they received a further notice.

After he conducted an initial Section 341 Meeting of Creditors on October 31, 1997, the Trustee filed: (1) a minute report which indicated that the case was now an asset case; and (2) an objection to the Debtors' claim that the Annuity was exempt property.

On November 20, 1997, an Asset Case Notice was sent to all creditors, including Cook. The notice advised all non-governmental creditors that, if they wished to share in any distribution of funds from the estate, they must file a proof of claim with the Clerk of the Bankruptcy Court by March 9, 1998 (the "Bar Date").

On July 2, 1998, the attorney for the Debtors filed a motion on behalf of Frank Wadsworth only (the "Withdrawal Motion"), which requested that he be allowed to withdraw his Chapter 7 case. The Withdrawal Motion alleged that: (1) the vast majority of the Debtors' scheduled unsecured indebtedness was incurred by Vanette Wadsworth in connection with two d/b/a businesses operated by her, Wadsworth Service Station and Wadsworth Garden Center; (2) his unsecured indebtedness was less than \$1,300.00;

BK. 97-23388

(3) the Debtors had reaffirmed or otherwise satisfactorily dealt with their secured indebtedness; and (4) he could pay his unsecured indebtedness outside of a Chapter 7 bankruptcy.

At an October 30, 1998 adjourned hearing on the Withdrawal Motion, the Court was advised that the Motion had been settled on terms which included that: (1) the amount of \$17,000.00 was to be turned over to the Trustee; and (2) a more detailed Order would be submitted.¹

On September 4, 1998, after the Bar Date, Cook filed an unsecured claim for \$43,763.95 (the "Cook Claim").

On May 14, 1999, the Trustee filed a motion (the "Objection Motion") which objected to the Cook Claim and stated that, the "claim filed late is subordinate to timely filed claims pursuant to 11 U.S.C. § 726(a)(2)(ii)(C) and will not realize a dividend."

Cook interposed Opposition to the Objection Motion which asserted that the Cook Claim should be allowed as a timely filed claim because: (1) the attorneys for Cook cooperated with the Trustee in performing the research that proved that the Annuity

¹ As of the date of this Decision & Order, no Order has been filed with or entered by the Bankruptcy Court.

BK. 97-23388

was not exempt as originally claimed by the Debtors; and (2) the Trustee did not directly advise the attorneys for Cook, who were actively participating in the case and assisting the Trustee, that he had filed papers with the Court that advised it that the Debtors' case was now being administered as an asset case.

By letter dated October 20, 1999, the attorneys for Cook withdrew their Opposition to the Objection Motion, and on November 8, 1999, the Court entered an Order disallowing the Cook Claim.

On June 29, 2001, the Trustee filed separate Final Reports for the estates of Frank Wadsworth and Vanette Wadsworth. The Frank Wadsworth Final Report: (1) showed gross receipts of \$33,745.11, including \$29,939.00 received by the Trustee from the 1998 payment on the Annuity; and (2) proposed to pay all administrative expenses in full and a one hundred percent (100%) distribution to all allowed timely filed unsecured claims.

By a July 16, 2001 letter, the attorneys for Cook objected (the "Cook Objection") to the Frank Wadsworth Final Report because it did not propose to keep the bankruptcy estate open so that the Trustee could receive and distribute to creditors, including Cook, the July 1, 2003 Annuity payment.

BK. 97-23388

By a Statement in Support of the Cook Objection, the attorneys for Cook represented that the Opposition to the Objection Motion had been withdrawn because of the expressed representation by the attorney for the Trustee who was handling the Objection Motion, that the "collection of the Annuity would in all likelihood derive sufficient assets to pay all claims, including the late claim filed by J.O. Cook."

At an October 26, 2001 adjourned hearing on the Frank Wadsworth Final Report, the Trustee, after reviewing the case file, indicated that he was prepared to revise the Final Report to make it an interim report and continue the administration of the Frank Wadsworth estate as proposed by the Cook Objection.

DISCUSSION

The Bankruptcy Code provides a scheme in Chapter 7 where honest debtors are required to surrender all of their nonexempt assets to the Trustee for distribution to their creditors in exchange for a discharge of their debts pursuant to Section 727.

To implement this scheme, the Bankruptcy Code sets forth the duties of a Chapter 7 Trustee in Section 704. Section 704(1) provides that the Trustee shall collect and reduce to money the property of the estate and close the estate as expeditiously as

is compatible with the best interests of parties in interest. Section 704(5) provides that the Trustee shall, if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper.

Section 726 sets forth the expenses of administration and the claims of creditors that a Chapter 7 Trustee must pay creditors before any assets of the estate can be refunded to a debtor. This distribution scheme, among its other provisions, requires that the assets of the estate be distributed to unsecured creditors who have filed timely proofs of claim (Section 726(a)(2)) as well as those who have tardily filed proofs of claim, those filed after a bar date but before any final distribution, (Section 726(a)(3)), before the Trustee can refund any monies to the debtor (Section 726(a)(6)).²

² Sections 726(a)(2), (a)(3) and (a)(6) provide that:

(a) Except as provided in section 510 of this title, property of the estate shall be distributed -

(2) second, in payment of any allowed unsecured claim, other than a claim of a kind specified in paragraph (1), (3), or (4) of this subsection, proof of which is -

(A) timely filed under section 501(a) of this title;

(B) timely filed under section 501(b) or 501(c) of this title; or

(C) tardily filed under section 501(a) of this title, if

(i) the creditor that holds such claim did not

During the course of the administration of the Debtors' case, it became clear that the Annuity proceeds, payable post-petition in July of 1998 and July of 2003, were nonexempt property of the estate which the Trustee had an obligation to collect and distribute to creditors until all of the claims of creditors allowable under Sections 726(a)(1) - (5) were paid in full. It would only be then that the Trustee could refund any excess amounts to the Debtors.

In most Chapter 7 cases, the nonexempt assets of the estate are insufficient to pay in full all timely filed proofs of claim, so that tardily filed claims never receive a distribution. In those cases, a disallowance of a claim only because it was filed late, not because the Trustee had a substantive objection, is the equivalent of disallowance in full. As a result, in those cases the orders generally

have notice or actual knowledge of the case in time for timely filing of a proof of such claim under section 501(a) of this title; and

(ii) proof of such claim is filed in time to permit payment of such claim;

(3) third, in payment of any allowed unsecured claim proof of which is tardily filed under section 501(a) of this title, other than a claim of the kind specified in paragraph (2)(C) of this subsection;

(6) sixth, to the debtor.

BK. 97-23388

submitted by the Panel of Chapter 7 Trustees and entered by the Court simply disallow the late filed claim, rather than correctly allowing it as a tardily filed claim in accordance with Section 726(a)(3).

In the Debtors' case: (1) the Trustee had no substantive objection to the Cook Claim; (2) the Objection Motion by its specific language was clearly only an objection to the Cook Claim being allowed as a timely filed claim, not to it being allowed as a tardily filed claim; (3) the Order disallowing the Cook Claim was clearly not intended by the Trustee or the Court to disallow the claim as a tardily filed claim; and (4) the Order should have allowed the Cook Claim as a tardily filed claim.

I believe the only reason that the Trustee filed the Frank Wadsworth Final Report without waiting to collect and distribute the July 2003 Annuity payment was that the attorney in the office of the attorneys for the Trustee that was handling the Objection Motion left the firm and failed to sufficiently review the Debtors' case with the Trustee. If he had, he would have identified to the Trustee that the case should remain open until the collection of the July 2003 Annuity payment and its

BK. 97-23388

distribution to creditors with tardily filed claims, including Cook, in accordance with the oral discussions between him and the attorneys for Cook that resulted in the withdrawal of the Opposition to the Objection Motion.

As a result of this case: (1) the Court will now require that the standard form orders submitted by the Panel of Chapter 7 Trustees in connection with their claim objection motions set forth the following four disposition alternatives to be checked: (a) disallowed; (b) allowed as a timely filed claim in the amount of \$_____; (c) allowed as a tardily filed claim in the amount of \$_____; and (d) other _____; and (2) the Claims Registers prepared by the Clerk's Office shall reflect the specific treatment of the claim in the Order.³

CONCLUSION

The Final Report in the Frank Wadsworth Chapter 7 case is not approved. In order to comply with his duties under Section 704 and the requirements of Section 726, the Trustee, as he has

³ Making it clear that there are allowed tardily filed claims in a case may be helpful to a Chapter 7 Trustee, the Office of the United States Trustee, and the Court in a variety of situations, including: (1) the preparation of a Final Report; (2) the determination of whether assets of the estate which cannot currently be collected or converted to money, but which may be collected or monetized at a future time, should be excepted from abandonment at the time of the closing of the case pursuant to Section 554(c); and (3) the determination of whether a Trustee will administer an unscheduled asset that is later discovered and brought to his attention after the closing of the case.

BK. 97-23388

acknowledged, must collect all or such portion of the Annuity proceeds due to be paid in July 2003 as will allow him to pay any additional expenses of administration and at least all allowed tardily filed claims, including the Cook Claim, before he refunds any of the proceeds to the Debtors.

It is unfortunate if the Debtors may have believed that, because all timely filed claims were being paid in full from the July 1998 Annuity proceeds and the other assets of the estate on hand, they were not going to be required to turn over the July 2003 Annuity payment for administration and distribution. However, that is what the provisions of the Bankruptcy Code require in order for them to receive their discharge.

IT IS SO ORDERED.

**HON. JOHN C. NINFO, II
CHIEF U.S. BANKRUPTCY JUDGE**

Dated: November 29, 2001