

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

In re:

DOUGLAS A. HILL,
RAMONA L. HILL,

Debtors.

Case No. 96-22423-MDM

Chapter 7

MEMORANDUM DECISION

INTRODUCTION

The debtors filed a motion for turnover of funds that the trustee recovered as a preferential transfer from Montello State Bank. The debtors had claimed these funds exempt and made demand of the trustee under 11 U.S.C. § 522(g). The trustee objected to the turnover of funds on the grounds that the debtors' preferential prepetition transfer to the creditor had been voluntary. The court held a hearing on the motion and received testimony from the debtors. Both parties have filed briefs. For the reasons stated herein, the court holds that the debtors are entitled to the exemption and will grant the debtors' motion.

The court has jurisdiction based upon 28 U.S.C. §§ 1334 (a), (b), and 157(a); this is a core proceeding under 28 U.S.C. § 157(b)(2)(B). This decision constitutes the court's findings of fact and conclusions of law pursuant to Fed. R. Bankr. P. 7052.

FACTS

Between 1992 and March 1996, when they filed their voluntary chapter 7 petition, the Hills entered into various loan agreements with Montello State Bank: a real estate mortgage on

the debtors' homestead and a vacant lot, two ready reserve account agreements, a consumer simple interest note for a vehicle, and a MasterCard Gold credit card. On January 27, 1996, the debtors sold the vacant lot which was subject to the mortgage. The sale price was \$19,000.00. At the closing on the lot, the Bank received the entire net proceeds less costs of sale, \$17,253.61, in return for providing the debtors with a partial release of mortgage.

According to a Bank officer, Mr. Hill told the Bank that it could apply the proceeds at its discretion (Wayne Pivotto Affidavit ¶ 5), which the debtors denied. At the hearing on the debtors' motion, both debtors testified that it was their understanding when their lot was sold, that Montello State Bank would apply the proceeds toward their principle mortgage balance. When they pledged the lot, it was with the understanding that doing so was in place of a down payment on their house; thus, they were able to finance the full cost of the house. The debtors also stated that the reason for selling the lot was to catch up on their mortgage and other debts.

At the time the house was purchased, the lot was valued at \$13,500.00, and the debtors expected that this amount would be applied to their home mortgage. Mr. Hill testified that he confirmed this value with the bank officer shortly before closing, and he understood payment of this amount was all that was necessary to release the lien on the lot. He informed the realtor of this, who prepared a check to the bank for \$13,500.00. However, shortly before the closing, the bank officer advised the realtor that all proceeds had to be remitted to the bank in exchange for the satisfaction, and a separate check to the bank for the remaining \$3,753.61 was prepared. The debtors testified that although they had expected to receive \$3,753.61 from the sale, they felt they were forced to close as was their legal obligation to the buyer.

Instead of applying the entire proceeds to the real estate mortgage note, the Bank applied

the proceeds from the sale of the lot as follows: (1) \$9,182.22 was applied to the debtors' MasterCard credit card debt; (2) \$4,935.62 was applied to the debtors' two Ready Reserve Accounts; (3) \$1,260.67 was applied to the debtors' delinquent real estate taxes;¹ (4) \$612.74 was applied to the debtors' vehicle loan with the Bank; and (5) \$1,262.36 was applied to the debtors' Mortgage Note.

On March 28, 1996, the debtors filed a voluntary petition for chapter 7 relief and were granted a discharge on July 17, 1996. The chapter 7 trustee filed an adversary proceeding against the Bank, alleging the Bank received a preference by applying the sale proceeds to the MasterCard, Ready Reserve Accounts and Vehicle Note. In a prior decision, dated July 1, 1997, *In re Hill*, 210 B.R. 1016 (Bankr. E.D. Wis. 1997), this court determined that the Bank's application of \$9,182.22 toward the debtors' MasterCard debt was a preference and could be avoided by the trustee. He was duly paid by the bank. Amounts paid on the debtors' other debts to the bank were subject to their real estate mortgage and could not be avoided. The debtors have now moved the court for an order requiring the trustee to turn over the sum of \$9,182.22, minus allowable collection costs of the trustee, to the debtors. If allowed, the full amount falls within the debtors' exemptions.

¹The debtors claim that, according to the County Treasurer's Office, no monies were paid on the delinquent real estate taxes. Instead, the money was applied to two mortgage payments. As far as the preference action is concerned, however, it is irrelevant whether the Bank applied the proceeds of the sale to delinquent real estate taxes or the debtors' mortgage.

ARGUMENTS

The debtors contend that they are entitled to claim the proceeds of the preference action as exempt pursuant to 11 U.S.C. § 522(g), because the allocation of the funds by Montello State Bank was involuntary. The debtors claimed an exemption in the proceeds of the preference action in their bankruptcy schedules, and the trustee did not object to the claimed exemptions. The trustee claims that the transfer of funds from the debtors to the Bank was a voluntary transfer, even though the allocation was not, and consequently, the funds cannot be claimed exempt under § 522(g).

DISCUSSION

Section 522(g), allows property recovered under the avoiding powers to be claimed exempt to the extent the property was not voluntarily transferred by the debtor and was not concealed. That provision provides:

Notwithstanding sections 550 and 551 of this title, the debtor may exempt under subsection (b) of this section property that the trustee recovers under section 510(c)(2), 542, 543, 550, 551, or 553 of this title, to the extent that the debtor could have exempted such property under subsection (b) of this section if such property had not been transferred, if —

- (1)(A) such transfer was not a voluntary transfer of such property by the debtor;
and
- (B) the debtor did not conceal such property; or
- (2) the debtor could have avoided such transfer under subsection (f)(2) of this section.

11 U.S.C. § 522(g). The court has already ruled that the transfer to the Bank of \$9,182.22 of the proceeds for the unsecured MasterCard payment was a preference. The contested issue is whether the debtors' payment to the Bank was "not a voluntary transfer" as that phrase is used in

§ 522(g)(1). If the transfer was voluntary, the debtors cannot claim the amount recovered by the trustee as exempt under § 522(g).²

The debtors have the burden of proving that the transfer was not voluntary under 11 U.S.C. § 522(g). *In re Trevino*, 96 B.R. 608, 613 (Bankr. E.D.N.C. 1989). The term “voluntary” is not defined in the Code. This court must look to the transaction as a whole to determine whether a particular required action or event that occurred within the confines of the entire transaction was voluntary or not. *In re Romano*, 175 B.R. 585, 597 (Bankr. W.D. Pa. 1994). If certain actions are necessary to complete a larger transaction, those actions are not thereby “involuntary,” provided that the debtor voluntarily chose to undertake the larger transaction. *Id.*

Generally, courts have held that transfers made pursuant to legal proceedings, such as execution or garnishment, are not voluntary. The voluntariness of other transfers is not so clear. One bankruptcy court explained that an involuntary transfer of property may occur under circumstances that, although not beyond the debtor’s control, involve fraud, material misrepresentation or coercion. *See In re Reaves*, 8 B.R. 177, 181 (Bankr. D.S.D. 1981).

Accordingly,

[A] voluntary transfer occurs when a debtor, with knowledge of all essential facts and free from the persuasive influence of another, chooses of her own free will to transfer

²The debtors argue that the trustee’s failure to object to the claimed exemption of the preference recovery is determinative. This may not be so, notwithstanding the inflexible rule of *Taylor v. Freeland & Kronz*, 503 U.S. 638, 112 S.Ct. 1644 (1992). *See, e.g., In re Alderman*, 195 B.R. 106, 111 (BAP 9th Cir. 1996) (ambiguities in debtor’s exemption schedules construed against debtor); *Mercer v. Monzack*, 170 B.R. 759, 762 (D. R.I. 1994) (court distinguished *Taylor* in that trustee never had reason to object because prior to increased personal injury settlement award, debtor had claimed only what he was legally entitled to); *In re Maylin*, 155 B.R. 605, 613 (Bankr. D. Me. 1993) (*Taylor* did not foreclose secured creditor from defending § 522(f) or § 522(h) action). However, since the court finds in the debtors’ favor on the merits, it is not necessary to make this determination under the facts of this case.

property to the creditor. A voluntary transfer does not occur where a creditor has harassed, insulted, and shamed a debtor into transferring the property to the creditor. Nor has a voluntary transfer occurred where a creditor has concealed or failed to inform a debtor of essential facts necessary for the debtor to make an intelligent decision on whether to transfer the property to the creditor. This is especially true where a debtor can show that she would not have made the transfer had she been informed of all the essential facts.

Id.

Most of the cases finding transfers involuntary under § 522(g) have involved specific threats or repeated harassment by creditors. In *In re Reaves*, the creditor “applied tremendous pressure” and threatened that the debtor’s husband’s business would fail unless the debtor signed a mortgage. *In re Reaves*, 8 B.R. at 181. The court found that the creditor had applied incessant pressure to “break [the] debtor’s spirit and convince her to sign.” *Id.* In *In re Taylor*, 8 B.R. 578, 579 (Bankr. E.D. Pa. 1981), the creditor made repeated phone calls to the debtor’s work and home over the course of several weeks and threatened to “take away her home.” *Id.* at 581. In *In re Johnson-Allen*, 69 B.R. 461, 470 (Bankr. E.D. Pa. 1987), *aff’d*, 495 U.S. 552, 110 S.Ct. 2126 (1990), the state probation department threatened the debtor with incarceration if he failed to pay a criminal restitution obligation.

Courts disagree whether or not payment made in response to legal coercion is voluntary. See *In re Via*, 107 B.R. 91, 94 (Bankr. W.D. Va. 1989) (payment made to avoid garnishment was involuntary); *In re Ricke*, 84 B.R. 408, 409 (Bankr. W.D. Pa. 1988) (payment in response to execution of judgment lien is involuntary); *Matter of Washkowiak*, 62 B.R. 884, 886 (Bankr. N.D. Ill. 1986) (satisfaction of an involuntary debt created by a judgment lien is not voluntary); *but see In re Trevino*, 96 B.R. 608, 613 (Bankr. E.D.N.C. 1989) (payments made “without forcing creditors to exercise their legal remedies” are not involuntary); *Matter of Huebner*, 18

B.R. 193, 194 (Bankr. W.D. Wis. 1982) (transfer not involuntary simply because debtor knows that the creditor would otherwise pursue other collection efforts).

There is no evidence that any bank officers acted in a harassing or threatening manner in order to procure the proceeds of the sale. Nevertheless, as noted above, some courts have also held transfers to be involuntary where (1) the debtor lacked essential facts related to the transfer; (2) the creditor to whom the transfer was made failed to inform the debtor of any essential facts within the creditor's knowledge; and (3) the debtor would not have made the transfer had he or she been aware of all the essential facts. See *In re Reaves*, 8 B.R. at 181; *In re Seidel*, 27 B.R. 347, 352 (Bankr. E.D. Pa. 1983); but see *In re Echoles*, 21 B.R. 280, 281-82 (Bankr. D. Ariz. 1982) ("Financial institutions are not required to issue 'Miranda type' admonitions. The failure to explain the effect of the deed of trust is insufficient to show an involuntary transfer.").

One court addressed the allocation of payments, as opposed to the payment itself, in a situation similar to the instant case. In *In re Hoffman*, 96 B.R. 46, 48 (Bankr. W.D. Pa. 1988), the court held that because the debtor was unable to affect the route of the proceeds of the sale of his house, the transfer was an involuntary transfer under § 522(g)(1). In addition to a mortgage, the debtor had voluntarily signed apparently unsecured notes containing a confession of judgment clause that resulted in a judicial lien on the house upon default. Subsequently, the debtor was forced to sell the house or face foreclosure of the judicial liens. The debtor was required by law to remit the proceeds from the sale to the judicial lien creditor. The debtor did not object to the transfer of title to the new owner or to the transfer of money in satisfaction of the mortgage. The debtor did, however, object to the use of the proceeds of the sale for partial satisfaction of a judicial lien. *Id.* at 47. The court held that the debtor was entitled to recover

part of the proceeds from the sale of the house which had been paid to the judicial lien creditor. The debtor's only choice in the matter was how he was going to lose his house, by sale or foreclosure. The choice did not involve whether the debtor was going to pay the judicial lien creditor. *Id.* at 48.

Here, the debtors' understanding, perhaps not shared by the bank, was that their home mortgage would be reduced, not that an unsecured MasterCard debt would be paid, when their lot was sold. The debtors credibly testified that they would not have agreed to the sale had they known of the allocation the bank had in mind. Once they learned they would receive nothing at the closing, their obligation to the buyer constituted "legal coercion" preventing their refusal to close. The payment to the Bank in two separate checks, when instructions to the realtor were changed immediately before the transaction, and correspondence between the debtors and the bank vehemently objecting to the bank's allocation of the proceeds bears out their lack of consent.

Accordingly, this court is satisfied that the allocation of lot sale proceeds to the debtors' unsecured MasterCard debt to the bank was an involuntary payment within the meaning of 11 U.S.C. § 522(g), and the debtors may claim the proceeds of the preference as exempt, less the reasonable costs of collection by the trustee. A separate order consistent with this decision will be entered.

Dated at Milwaukee, Wisconsin, October 21, 1997.

BY THE COURT:

_____/s/_____
Margaret Dee McGarity
United States Bankruptcy Judge

