

UNITED STATES BANKRUPTCY COURT

DISTRICT OF SOUTH DAKOTA

ROOM 211

FEDERAL BUILDING AND U.S. POST OFFICE

225 SOUTH PIERRE STREET

PIERRE, SOUTH DAKOTA 57501

IRVIN N HOYT
CHIEF BANKRUPTCY JUDGE

TELEPHONE (605) 224-0560
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January 31, 1997

Ms. JoAnne Heikes
Post Office Box 144
Lesterville, South Dakota 57040

A. Thomas Pokela, Esq.
Defendant and Former Trustee
Post Office Box 1102
Sioux Falls, South Dakota 57101

Caitlin F. Collier, Esq.
Defendant and Counsel for Defendant Russell Heikes
Post Office Box 435
Vermillion, South Dakota 57069-0435

Subjects: **Heikes v. Heikes, et al.**
(In re JoAnne Heikes),
Adversary No. 96-4037

In re JoAnne Heikes,
Chapter 7; Bankr. No. 93-40002

Dear Ms. Heikes, Mr. Pokela, and Ms. Collier:

The matters before the Court are Debtor's adversary complaint against Russell Heikes, his attorney, Caitlin F. Collier, and former trustee A. Thomas Pokela, the answers thereto, and the related summary judgment motions and Debtor's MOTION TO AVOID LIEN ON DEBTOR'S EXEMPT PROPERTY. These are core matters under 28 U.S.C. § 157(b)(2) and have been combined for decision because the same exempt property is at issue. This letter decision and accompanying Order shall constitute the Court's findings and conclusions pursuant to F.R.Bankr.P. 7052. As set forth below, the Court concludes that Russell Heikes does have lawful possession of two rings, silverware and some quilts in which he has a security interest and that his liens on this exempt property may not be removed by Debtor under 11 U.S.C. § 522(f).

SUMMARY OF MATERIAL FACTS. Debtor's Chapter 13 plan was confirmed on June 14, 1993. The plan acknowledged that Russell Heikes, Debtor's brother, had a secured interest in jewelry, silverware, and quilts. Debtor proposed to repay this claim over time. Debtor also requested in her plan that the case trustee, A. Thomas Pokela, take possession of these items and then surrender them to her when the claim was paid in full.

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Russell Heikes did not accept the plan payments that were offered. On May 30, 1995, the Court ruled that Russell Heikes was bound by the confirmed plan, that he still had a security interest in certain rings, quilts, and silverware, and that Debtor had to pay Russell Heikes \$1,500.00 under her plan to regain possession of them. Russell Heikes gave possession of the secured property to Trustee Pokela as requested by Debtor in her plan (it was not a mandatory provision of the plan).

Against Debtor's strong and continued protests, her case was converted to a Chapter 7 on January 11, 1996. On May 23, 1996, Debtor filed an amendment to her schedule of exempt property. Trustee Pokela objected. On July 12, 1996, Debtor filed second amended exemptions and served them on Trustee Pokela and her creditors.¹ No timely objections were filed. Debtor's second amended exemptions included, among other items not pertinent to these matters:

"one diamond ring, one saffire [sic] ring" under S.D.C.L. § 43-45-2; and

"household furnishings, furniture, bedding, silverware," valued at \$450.00 under S.D.C.L. § 43-45-4.

Quilts were not specifically identified on this second amended schedule of exempt property but throughout her pleadings Debtor has presumed that the quilts are included as part of her exempt bedding. No one has disputed that presumption.

On or about August 6, 1996, Trustee Pokela returned possession of the rings, quilts, and silverware to Russell Heikes.

On September 4, 1996, Debtor filed an amended complaint against Russell Heikes, his attorney Caitlin Collier, and Trustee Pokela in Adversary No. 96-4037. Debtor sought return of the rings, quilts, and silverware from Russell Heikes. Debtor argued that she was entitled to possession because the property was exempt. She also argued that the Defendants violated the automatic stay by allowing Trustee Pokela to return the property to Russell Heikes. Debtor wanted the Court to impose substantial penalties on all three parties for their roles in returning the exempt property to Russell Heikes. In their answers, the Defendants initially contended that the rings were not exempt property but were only security to be held by Russell Heikes.

¹ Russell Heikes was served. Attorney Collier was not. She has not filed a formal notice of appearance for Russell Heikes.

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All parties moved for summary judgment. Defendants Collier and Russell Heikes argued that Debtor had no standing and that this Court had no jurisdiction because Debtor's discharge had been entered, that Debtor had asserted a claim for which no relief could be fashioned, and that Debtor no longer could reaffirm the debt with Russell Heikes. Defendant Pokela argued in his motion for summary judgment that Debtor's claim that the property was exempt did not remove Russell Heikes' secured interest in that property. Plaintiff-Debtor argued in her motion for summary judgment and brief that Russell Heikes no longer had a secured interest in the property because he failed to file a proof of claim and that she had advanced Trustee Pokela enough money to pay Russell Heikes' claim in full. Both of Debtor's contentions have been previously addressed by the Court and will not be addressed again herein. Plaintiff-Debtor also argued that she could claim secured property exempt, that she could exercise § 522(f) to free this exempt property from Russell Heikes' secured interest, and that she has standing to bring this action because the case is still open.

On December 6, 1996, Debtor filed a MOTION TO AVOID LIEN ON DEBTOR'S EXEMPT PROPERTY. Therein, Debtor requested that Russell Heikes' liens on the quilts, silverware, and two rings be avoided under 11 U.S.C. § 522(f)(2)(A). In the MOTION, Debtor stated, "As there is no judicial lien attached to any of the above property[,] the removal of the above liens should stand uncontested." The MOTION was served on Trustee Pokela, Russell Heikes, Attorney Collier, and the United States Trustee but a last date for objections was not noticed to any of them. No responses were filed.

The key issues presented by Debtor's complaint and her MOTION TO AVOID LIEN ON DEBTOR'S EXEMPT PROPERTY are: (1) whether Russell Heikes' security interest in the exempt property can be removed under § 522(f); and (2) whether Trustee Pokela properly returned to Russell Heikes the exempt property in which Russell Heikes had a possessory security interest on the petition date. Defendants Russell Heikes and Caitlin Collier also challenge this Court's jurisdiction and Debtor's standing.

JURISDICTION AND DEBTOR'S STANDING. Contrary to Defendants Russell Heikes' and Caitlin Collier's assertion, the entry of Debtor's discharge does not deprive this Court of jurisdiction nor does it deprive Debtor of standing to either amend her exemptions or file a motion under § 522(f). Under F.R.Bankr.P. 1009(a), a debtor may amend her schedules anytime before the case is closed. While a discharge order has been entered, this case is still open. Further, there is no pre-discharge deadline for filing a § 522(f) motion to avoid lien on exempt property. Accordingly, this Court has jurisdiction and Debtor has standing under § 522(f).

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Whether Debtor may still reaffirm her debt with Russell Heikes is not at issue as she has not formally sought to do so. Consequently, if Russell Heikes' liens survive Debtor's § 522(f) motion, then he may enforce those liens against the secured property, but not against Debtor personally, when permitted by 11 U.S.C. § 362(c) and as provided by his written agreements with her.

THE STATUS OF DEBTOR'S EXEMPT PROPERTY. No objections to Debtor's July 12, 1996 second amended exemptions were filed timely and that property was removed from the bankruptcy estate. *Abramowitz v. Palmer*, 999 F.2d 1274, 1276 (8th Cir. 1993) (citing *Taylor v. Freeland & Kronz*, 112 S.Ct. 1644 (1992)). The exemptions stand as claimed, limited to the descriptions and values set forth therein. *Plotkin v. Hyman (In re Hyman)*, 967 F.2d 1316, 1319 (9th Cir. 1992); *In re Sherbahn*, 170 B.R. 137, 140 (Bankr. N.D. Ind. 1994); and *In re Shoemaker*, 155 B.R. 552, 555 (Bankr. N.D. Ala. 1992).

THE STATUS OF RUSSELL HEIKES' SECURED INTEREST IN THE EXEMPT PROPERTY. When determining the nature or status of exempt property for the purpose of a § 522(f) motion, the Court must look to the petition date. See generally *In re Punke*, 68 B.R. 936 (Bankr. N.D. Ia. 1987)². The nature of Russell Heikes' secured interest in each item on the petition was previously determined by this Court in its May 30, 1995 decision.

The October 10, 1988 and November 18, 1988 agreements clearly provide that Debtor got loans from Russell Heikes, that she gave him rings as security, and that the loans were to be paid by a date certain. Both repayment dates had expired at the time Debtor filed her last petition. The agreements do not state what, if any, actions Russell Heikes must take to obtain title to the rings. State law fills that gap.

² In *Armstrong v. Lindberg (In re Lindberg)*, 735 F.2d 1087 (8th Cir. 1984), the court held that the date of conversion from a Chapter 13 to a Chapter 7 determined what exemptions a debtor could claim. Since that decision, however, the Bankruptcy Code has been amended to clarify that the estate of a Chapter 13 case converted to a Chapter 7 case is essentially the original estate that existed on the Chapter 13 petition date. See 11 U.S.C. § 348(f) (1994). Therefore, the *Lindberg* rationale is drawn into doubt. See *Lowe v. Sandoval (In re Sandoval)*, 103 F.3d 20 (5th Cir. 1997).

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Under S.D.C.L. § 57A-9-203, Russell Heikes had an enforceable secured interest in the rings described in the October 10, 1988 and November 18, 1988 agreements. He had possession of the rings, value had been given, and debtor had rights in the collateral given. When Debtor defaulted on the agreements by not repaying the loan timely, Russell Heikes could accept the collateral as a discharge of Debtor's obligation pursuant to S.D.C.L. § 57A-9-505(2). However, before doing so, Russell Heikes had to give notice to Debtor as required by § 57A-9-505(2). Since Russell Heikes has never given Debtor the notice required by § 57A-9-505(2), then S.D.C.L. § 57A-9-506 provides that she may still cure the default. Thus, the debts created by the October 10, 1988 and November 18, 1988 agreements still existed on Debtor's petition date and may be treated in her plan. Russell Heikes is bound by that plan treatment. 11 U.S.C. § 1327(a).

. . . .

In contrast, the April 19, 1992 agreement states Debtor may reclaim the silverware in a wooden box "anytime" by repaying that loan. Although the agreement said the note was to be repaid within six months, the reclamation provision was not so narrow. Therefore, Debtor's interest in this security still existed at the time of Debtor's petition and may be treated through the confirmed plan.

Similarly, the undated notes signed only by Russell Heikes allow Debtor to get back some quilts upon repayment of those loans. Since there is no time deadline and since Russell Heikes did not give Debtor any notice under S.D.C.L. § 57A-9-505(2), those claims existed at the time of her petition and could be treated in the confirmed plan.

As discussed above, Debtor gave Russell Heikes a possessory secured interest in the rings, silverware, and quilts. Russell Heikes still had that possessory secured interest on the day Debtor filed her bankruptcy petition. Accordingly, that is the status or nature of his security interest that must be considered under § 522(f)(2).

It used to be a common phrase heard in bankruptcy law circles that a lien on estate property generally survives a bankruptcy case. The Court of Appeals for the Eighth Circuit recently explained why that generality is too broad.

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[A] lien may be removed from collateral and replaced by adequate protection if the trustee obtains permission to sell property free and clear of liens, see 11 U.S.C. § 363(e)-(f) (1994), or voided if the related claim is disallowed, see 11 U.S.C. § 506(d) (1994), or avoided to the extent it impairs an exemption of the debtor, see 11 U.S.C. § 522(f) (1994), or avoided if it is the result of a preference or a fraudulent transfer, see 11 U.S.C. §§ 547-548 (1994).

Harmon v. United States, 101 F.3d 574, 581 (8th Cir. 1996). All these provisions apply in a Chapter 7 case. The one at issue here is whether Russell Heikes' possessory liens on the exempt property survive Debtor's § 522(f) motion and, therefore, whether he rightly has regained possession of the exempt property from the case trustee. That Debtor has declared this property exempt does not alone render his lien valueless. Instead, we must apply § 522(f).

APPLICATION OF § 522(F). While state law determines what property a debtor may declare exempt in this District, federal law determines whether a lien on that exempt property may be avoided. *In re Thompson*, 750 F.2d 628, 630 (8th Cir. 1984). Section 522(f)(1) of the federal Bankruptcy Code governs the removal of either a judicial lien or a "nonpossessory, nonpurchase-money security interest" on exempt property. Russell Heikes' security interests in Debtor's rings, silverware, and quilts were not judicial liens as described by §§ 101(36) and 522(f)(1)(A) so we must look at § 522(f)(1)(B).

Section 522(f)(1)(B) states that a "nonpossessory, nonpurchase money security interest" may be avoided on certain exempt property. However, Russell Heikes had a *possessory* secured interest in this property on the petition date by virtue of the original agreements he and Debtor had. See generally *In re Schultz*, 101 B.R. 68 (Bankr. N.D. Iowa 1989). Consequently, his possessory interest cannot be voided by Debtor under § 522(f)(1)(B) and Debtor's MOTION TO AVOID LIEN ON DEBTOR'S EXEMPT PROPERTY must be denied. Section 522(f) is not reached since the motion failed under subsection (f)(1).

Congress did not intend that all liens on exempt property could be voided. *Thompson*, 750 F.2d at 631. Instead, Congress chose a balance between creditors and debtors. When § 522(f) is applied in this case, it does not alter the original security agreement between the parties.

APPROPRIATENESS OF TRUSTEE TURNING OVER SECURED, EXEMPT PROPERTY TO THE SECURED CREDITOR. Having now determined that Russell Heikes'

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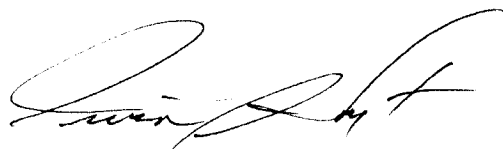
possessory security interest in the rings, silverware, and quilts cannot be voided by Debtor under § 522(f), the last question for the Court to answer -- the one raised by Debtor's adversary complaint -- is whether then Trustee Pokela properly returned this secured, exempt property to Russell Heikes when Debtor's case was converted from a Chapter 13 to a Chapter 7. Several Bankruptcy Code sections guide us.

First, under 11 U.S.C. § 522(b)(1), the jewelry, silverware, and quilts were removed from the bankruptcy estate when Debtor declared them exempt and no one objected. Accordingly, the Trustee was no longer obligated to keep possession of it. 11 U.S.C. § 704(1). Further, Russell Heikes' possessory liens on the property have not been satisfied by payment or voided in the bankruptcy proceeding under § 522(f). Accordingly, Russell Heikes was entitled to be placed back in his pre-petition status and to have this secured property returned to him by the Trustee.

The only effect that this bankruptcy case ultimately had on Russell Heikes' claims against Debtor is that his claims against her must be reduced by the payments, if any, that he actually received from the Chapter 13 trustee as provided by 11 U.S.C. § 348(f)(1)(B), or that he may receive in any Chapter 7 distribution as provided by 11 U.S.C. § 726. Those matters will all be for a state court to sort out, if necessary, since the parties are returned to their pre-bankruptcy status. This Court no longer has jurisdiction.

Appropriate orders will be entered denying Debtor's MOTION TO AVOID LIEN ON DEBTOR'S EXEMPT PROPERTY and awarding judgment for the Defendants in the adversary proceeding. No costs will be awarded to any party.

Sincerely,



Irvin N. Hoyt
Chief Bankruptcy Judge

CERTIFICATE OF SERVICE

I hereby certify that a copy of this document was mailed, hand delivered, or faxed this date to those creditors and other parties to interest identified on the attached service list.

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court
District of South Dakota

By: LNH:sh
Date: 1/31/97

CC: adversary file (docket original; copies to parties interested)
case file (docket copy)
United States Trustee
Trustee John S. Lovald

NOTICE OF ENTRY
Order F.R. Bankr.P. 9022(a)
Entered

JAN 31 1997

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court
District of South Dakota

Case: 96-04037 Form id: 122 Ntc Date: 01/31/97 Off: 4 Page : 1
Total notices mailed: 8

Plaintiff Heikes, Joanne PO Box 144, Lesterville, SD 57040
Defendant Heikes, Russell RR 1, Vermillion, SD 57069
Aty Collier, Caitlin F. PO Box 435, Vermillion, SD 57069-0435
Aty Entwistle, Rick 300 S Phillips Ave Ste 300, Sioux Falls, SD 57104-6322
Aty Gors, John A. PO Box 396, Vermillion, SD 57069
Trustee Pokela, A. Thomas PO Box 1102, Sioux Falls, SD 57101-1102
Trustee Pokela, A. Thomas PO Box 1102, Sioux Falls, SD 57117-1102
Aty Thompson, Craig K. PO Box 295, Vermillion, SD 57069

Case: 93-40002 Form id: 122 Ntc Date: 01/31/97 Off: 4 Page : 1

Total notices mailed: 6

Debtor Heikes, Joanne PO Box 144, Lesterville, SD 57040
Aty Damgaard, Roger W. 300 S Phillips Ave Ste 300, Sioux Falls, SD 57102
Aty Entwistle, Rick 300 S Phillips Ave Ste 300, Sioux Falls, SD 57104-6322
Aty Gering, Bruce J. Office of the U.S. Trustee, #502, 230 South Phillips Avenue, Sioux Falls, SD 57104-6321
Aty Gors, John A. PO Box 396, Vermillion, SD 57069
Aty Thompson, Craig K. PO Box 295, Vermillion, SD 57069