

UNITED STATES BANKRUPTCY COURT

DISTRICT OF SOUTH DAKOTA

ROOM 211

FEDERAL BUILDING AND U.S. POST OFFICE

225 SOUTH PIERRE STREET

PIERRE, SOUTH DAKOTA 57501-2463

IRVIN N. HOYT
BANKRUPTCY JUDGE

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March 23, 1989

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Re: John D. and Kellie B. Lipp
Chapter 7 88-50112

Dear Counsel:

In this case the Court considers whether Chapter 7 debtors may exempt from the bankruptcy estate profit obtained from a post-petition sale of real property, where the debtors redeemed the property post-petition from a pre-petition foreclosure sale. To make this determination the Court must decide the following issues:

First, whether a statutory redemption right existing at the time bankruptcy was filed is property of a Chapter 7 estate.

Second, if the first question is answered in the affirmative, the Court must then decide if the proceeds of the post-petition sale of the redeemed real estate remained encumbered by a second mortgagee which failed to foreclose upon the property at the pre-petition foreclosure sale, or are unencumbered and available to satisfy unsecured claims -

Third, the Court must determine if the proceeds may be exempted from the estate under the debtors' homestead exemption.

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As to the first issue, it is a basic feature of the Bankruptcy Code that "property of the estate" is given a very broad definition. See, ~ §541; 4 Collier on Bankruptcy para. 541.01 (15th ed. 1989). Accordingly, the Eighth Circuit has held that where a foreclosure sale is completed prior to filing bankruptcy, the statutory right of redemption "passes into the bankruptcy estate if the redemption period has not expired at the time of [sic] the bankruptcy petition is filed." Johnson v. First National Bank of Montevideo, Minn., 719 F.2d 270, 276 (1983) cert. denied, 465 U.S. 1012 (1984) , citing 4 Collier on Bankruptcy para. 541, 07[3] at 541-30 (15th Ed. 1983). The debtors' right of redemption therefore was part of the bankruptcy estate at the time of filing.

As to the second issue, Debtors argue Norwest's mortgage was extinguished when the Bank failed to participate in the pre-petition Sheriff's sale. In some jurisdictions the debtors' argument might be a correct statement of the law. See 55 Am. Jur.2d Mortgages §901 (1971). In South Dakota¹, however, the state Supreme Court has held "A redemption by the mortgagor or his successor in interest terminates the effect of the sale and restores to him, free of the incumbrance of the mortgage foreclosed, his property, SDC 33.2104, and leaves the property subject to junior liens." Rist v. Anderson, 19 NW2d 833, 835 (1945) (emphasis supplied).

The statute cited in Rist providing that the "effect of the sale is terminated" upon redemption is currently in effect in SDCL 21-52-24. The state Supreme Court has not modified its holding in Rist. Nor have the debtors or Mountain Plains Bank supplied any authority placing the validity of Rist in question. I therefore hold that under South Dakota law, by virtue of the debtors' redemption, Norwest's second mortgage survived the foreclosure of the first mortgage.

As to the third issue, Mountain Plains Bank and debtors argue that the profit from the post-petition sale is proceeds of the

¹ Although it is a point hardly requiring support by authority, South Dakota law governs the realty in this District absent conflict with federal bankruptcy law. In re Rice, 42 B.R. 838 (Bkrtcy. D. S.D. 1984) (and cases, cited therein).

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debtors' homestead and should be exempted from the estate.² The Court need look no further than its proof of claim file, which contains a copy of Norwest's mortgage. Contained in paragraph 23 thereof is a homestead waiver. If the mortgage interest of the Bank was revived upon redemption, as Rist provides, so was the homestead waiver it contained. South Dakota law and the Bankruptcy Code recognize such waivers,³ and the homestead and its proceeds are not exempt.

Debtors also argue that even if the proceeds were not exempt, Norwest has waived its right to object to the debtors' claim that the proceeds were exempt. The debtors' Schedule B-4 contains the following entry: "homestead SDCL 43-43-3 & 43-41[sic] \$30,000.00". Rule 4003(b) requires an objection to claimed exemptions to be made within thirty days after the conclusion of the 341 Meeting, or the filing of an amendment to the schedule. No objection to the debtors' claimed exemptions were filed. Section 522(1) of the Code provides that the property claimed on Schedule B-4 is exempt unless a party in interest objects.

I am unwilling to hold that the debtors' listed homestead exemption placed creditors on notice that the debtors would redeem the home, sell it for a profit and retain the proceeds. I further hold that the debtors had the duty to amend their schedules after the post-petition sale to place creditors on notice that the proceeds were claimed as exempt. See B.R. 1007(h). Because the debtors failed to amend their claim of exemptions to add the proceeds, the period in which to object to the claimed exemption had not begun to run. See B.R. 4003(b).

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² The Court surmises that the debtors and Mountain Plains Bank advanced this argument in the belief that if the proceeds are exempted from the estate the funds will be available for the debtors' use, unencumbered by a security interest. In truth, if Norwest's security interest is unavoidable in bankruptcy, and the debtors do not argue that the mortgage is avoidable, the Norwest mortgage would remain attached to the proceeds even though exempted from the estate. See e.g. 3 Collier on Bankruptcy para. 522.27 (15th ed. 1989)

³ E.g., In re Hlavac, 73 B.R. 612, 613 (Bkrtcy. D. S.D. 1987); See §522(e).

For the foregoing reasons the, debtors are unable to exempt the proceeds of the sale from their bankruptcy estate. In addition, there is an alternative basis to disallow the claimed exemption. The redemption occurred while in Chapter 7. A Chapter 7 debtor's right to redeem property is governed by Section 722 of the Code. This Section empowers such debtors to redeem only certain exempt personal property. A Chapter 7 debtor is without the power to redeem realty. E.g., *Gaglia v. First Federal Savings and Loan (In re Gaglia)*, 1989 W.L. 20449 (W.D. Pa. 1989); *In re Dewsnap*, 87 B.R. 676, 680 (Bkrtcy. D. Utah 1988), quoting *In re Maitland*, 61 B.R. 130, 135 (Bkrtcy. E.D. Va. 1986); *In re Mahaner*, 34 B.R. 308 (Bkrtcy. W.D. N.Y. 1983); 4 Collier on Bankruptcy para. 722.02 (15th Ed. 1989).

In closing, I would state that denying the debtors' attempt to realize a profit from the redeemed real estate is not only legally sound under the above analysis, but the only equitable result. Many points of bankruptcy law and its relation to state law can be argued. However, it can be said with certainty that the law does not allow a Chapter 7 debtor to convert an asset of the bankruptcy estate into a profit, and retain that profit for the debtor's use.

The Order accompanying this opinion sets forth the disposition of the case and the relief granted Norwest Bank. Norwest Bank complains that under Mountain Plains Bank's agreement with the debtors to loan the funds necessary to redeem the property, Mountain Plains Bank is to receive one-half of the net proceeds realized from the sale of the redeemed home. Mountain Plains Bank apparently is also an unsecured pre-petition creditor of the debtors. Under this opinion Mountain Plains Bank, as the debtors, has no claim to the net proceeds. This result obviates Norwest's complaint that Mountain Plains Bank would be unfairly favored as to its pre-petition claim if it were allowed to share in the net proceeds.

This matter constitutes a core proceeding under 28 U.S.C. §157(b) (2). This opinion shall constitute the Court's conclusions of law. Findings of fact are not required on a stipulated record. The Court shall enter an appropriate order.

Very truly yours,

Irvin N. Hoyt
Chief Bankruptcy Judge

CC: Bankruptcy Clerk
U.S. Trustee
Chapter 7 Trustee