

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

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March 7, 1997

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Chapter 7 Trustee
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Counsel for Debtor
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Sioux Falls, South Dakota 57118

Subject: ***In re Melvin D. Van Dentop,***
Chapter 7; Bankr. No. 95-40644

Dear Trustee and Counsel:

The matter before the Court is the Objection to Claimed Exempt Property filed by Trustee Yarnall and Debtor's response thereto. This is a core proceeding under 28 U.S.C. § 157(b)(2)(B). This letter decision and accompanying Order shall constitute the Court's findings and conclusions under F.R.Bankr.P. 7052. As set forth below, the Court will sustain the Trustee's objection to the extent the value of Debtor's policy with Life Investors was enhanced by a post-petition payment of \$2,200.00. Any post-petition payment to Life Investors or other creditors may be voidable by the Trustee under § 549(a).

SUMMARY OF FACTS. Debtor filed a Chapter 7 petition on November 13, 1995 at 4:29 p.m. In his schedules filed that same day, Debtor claimed as exempt under S.D.C.L. § 43-45-4, a 1979 Buick Regal valued at \$200.00, a 1987 Ford Escort EXP valued at \$850.00; an Individual Retirement Account with Merrill Lynch valued at \$35.00; stock in Naturlawn valued at \$475.00; nondescript "Personal Effects" valued at \$300.00, and a checking account at Norwest Bank valued at \$300.00. The value of exemptions that Debtor claimed under S.D.C.L. § 43-45-4 totaled \$2,160.00. Under S.D.C.L. § 58-12-4 Debtor also claimed exempt the \$1,787.00 in cash value in a policy with Northwestern Mutual Life and \$3,350.00 in cash value in a policy with Life Investors.

Trustee Yarnall filed an objection December 22, 1995 on the grounds that the value of the property claimed exempt exceeded the

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permissible allowance of \$2,000.00 under § 43-45-4. The Trustee also argued that Debtor may have an interest in a cooperative or corporation known as East Dakota Natural Foods that could not be lawfully exempted.

Debtor filed a response on July 5, 1996. Therein, Debtor stated that on the petition date his checking account had only \$304.74 when outstanding checks were deducted. Debtor acknowledged that outstanding checks on the petition date plus the balance of \$304.74 totaled \$3,539.83. Debtor went on to argue that *Barnhill v. Johnson*, 112 S.Ct. 1386 (1992), which states that the transaction date for a check in a preference action under 11 U.S.C. § 547(b) is the date it is honored, did not apply in this exempt property situation. Debtor also acknowledged that one of the checks written but not honored on the petition date went toward purchasing exempt life insurance for Debtor. Debtor argued that the Trustee should have filed a motion for turnover to recover these funds rather than an objection to exemptions.

An evidentiary hearing was held August 7, 1996.¹ Appearances included Trustee Yarnall and Wesley D. Schmidt for Debtor. The Trustee further developed his objection at the hearing. In essence, he argued that Debtor could not declare exempt his interest in the cash value of his life insurance because the check had not cleared before his petition was filed. On the petition date, these funds were still cash in Debtor's checking account and thus, the Trustee argued, the funds were property of the estate, not life insurance that Debtor could claim exempt.

Debtor testified that he had failed to schedule his interest in Nature Foods (or a similarly named entity) worth \$8,000.00 and that he had failed to schedule a leaf blower that he purchased on the petition date. Debtor also testified that on the petition date the balance of his checking account was \$3,776.24.² The large balance came from an IRA with Merrill Lynch worth over \$3,600.00 that Debtor had cashed and deposited in his checking account. (In fact, Debtor earlier had borrowed against his Life Investor's policy to purchase the IRA.)

Debtor identified several checks that he had written just

¹ An earlier settlement fell through.

² The bank statements indicate the balance was \$3,679.83.

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before or on the petition date that had not cleared his account on the petition date. These checks totaled approximately \$3,264.96. Several were for antecedent debts. The largest check, written on the November 13, 1995 petition date, was for \$2,200.00 to Life Investors. Debtor testified that he used the \$2,000.00 to pay back a loan on this life insurance policy and that he applied another \$200.00 to the policy's cash value.

According to additional information supplied by the parties after the hearing, Debtor delivered the check in person on November 13, 1995 to an agent for Life Investors before he filed his bankruptcy petition. Life Investors cashed the check several days later. According to Life Investors, the \$2,200.00 check from Debtor restored the full death benefit of \$45,740.00 on Debtor's policy. If the loan had not been paid back, Life Investors would have subtracted the loan balance from the full death benefit. Further, the check had to clear before Life Investors considered the loan paid. The information provided by Life Investors did not state that \$2,000.00 was for the loan repayment and that the remaining \$200.00 was for additional coverage. The cash value of the policy on the petition date, before the \$2,200.00 was credited, is not known.

The first issue is whether Debtor may declare the Life Investors policy exempt where the loan repayment check to Life Investors had not cleared before the petition date.³ The second issue is whether the Trustee may recover from Debtor for the checks that were written pre-petition but cashed post-petition.

DISCUSSION. Debtor's repayment of a loan on his life insurance was not the transformation of non exempt property into exempt property, which is generally allowed as long as it is not done to defraud creditors. See generally *Federal Savings and Loan Insurance Corp. v. Holt (In re Holt)*, 894 F.2d 1005, 1008 (8th Cir. 1990). Instead, Debtor was actually repaying a debt. As Life Investors stated, had Debtor died immediately after presenting the check, he would have received the benefits under his policy less the loan balance. It was not until the check cleared that Life Investors considered the loan paid and that the company would have

³ If Debtor does not amend his schedules promptly to include missing items such as the leaf blower and his interest in any businesses, Trustee Yarnall or another party in interest may file a motion to compel Debtor to do so under F.R.Bankr.P. 1009(a).

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paid Debtor his full benefits. Thus, these funds were a debt repayment, not as the creation of exempt property.

The question then becomes, was the money in Debtor's account on the petition date estate property or Life Investor's property? Case law on preferences provides guidance. When determining whether a preferential transfer under § 547(b) has occurred, funds are considered transferred when a check is honored. *Barnhill v. Johnson*, 112 S.Ct. 1386, 1390-91 (1992). In contrast, when determining whether a "new value exception" to a preference exists under § 547(c)(4), the date the check was delivered is used. *Kroh Brothers Development Co. v. Continental Construction Engineers, Inc. (In re Kroh Brothers Development Co.)*, 930 F.2d 648, 650-51 (8th Cir. 1991). The earlier date is used for establishing the exception to a preferential transfer so that creditors are encouraged to deal with troubled businesses while the later date is used for determining when the preferential transfer occurred to insure equality of distribution. *Id.*

After considering these distinct policies, this Court holds that the date a check is honored should be used when determining whether an avoidable post-petition transfer has occurred. S.D.C.L. § 57A-3-408; *Clendenen v. Van Dyk Oil Co.*, 89 B.R. 906, 908-10 (D. Utah 1988); *Steege v. AT & T (In re Superior Toy & Manufacturing Co.)*, 183 B.R. 826, 837 (Bankr. N.D. Ill. 1995); *Wittman v. State Farm Life Insurance Co. (In re Mills)*, 167 B.R. 663, 664 (Bankr. D. Kan. 1994), *aff'd*, 176 B.R. 924, 926-27 (D. Kan. 1994); *Shanor v. Chappell & Barlow (In re Bellamah Community Development)*, 139 B.R. 29, 30-31 (Bankr. D.N.M. 1992); *In re Lange*, 100 B.R. 907, 909-10 (Bankr. D. Minn. 1990); *Nixon v. I.R.S. (In re Her Majesties Stout Shop, Inc.)*, 65 B.R. 145, 147-48 (Bankr. M.D. Fla. 1986); and *Dubuque Packing Co. v. Stonitsch (In re Isis Foods, Inc.)*, 37 B.R. 334, 336 (W.D. Mo. 1984); *contra Quinn Wholesale, Inc. v. Northern*, 110 B.R. 271, (M.D. N.C. 1988), *aff'd*, 873 F.2d 77, 78 (4th Cir. 1989); *Tarver v. Trois Etoiles, Inc. (In re Trois Etoiles, Inc.)*, 78 B.R. 237, 238-39 (9th Cir. BAP 1987)⁴. Until a bank pays the

⁴ The *Trois Etoiles* decision has been called into question by *Spear v. CEMA Distribution (In re Rainbow Music, Inc.)*, 154 B.R. 559 (Bankr. N.D. Ca. 1993). Therein, the court noted that *Trois Etoiles* had been decided before the Supreme Court's decision in *Barnhill v. Johnson*, 112 S.Ct. 1386 (1992), and concluded that *Barnhill* dictated that the date of honor be used when considering a post-petition transfer under § 549(a).

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holder, the debtor's presentment of a check to a creditor does not transfer funds out of the account; the bank must honor the check for the funds to be removed. Further, since the date of honor is used for preference purposes, which applies only to pre-petition transfers, it follows that the date of honor should be used when considering whether a post-petition transfer occurred. *Steege*, 183 B.R. at 837; *Shanor*, 139 B.R. at 30-31. A gap would be created if the date of honor was used for preference purposes but the date of presentment was used for post-petition transfers; checks written pre-petition but honored post-petition, as in this case, would not be subject to avoidance under either § 547(b) or § 549(a). *Steege*, 183 B.R. at 837. Finally, equality of distribution is promoted when the date of honor is used. *Maurer v. Hedback (In re Maurer)*, 140 B.R. 744, 746 (Bankr. D. Minn. 1992).

When the date of honor is considered in this case, it is clear that the check to Life Investors was still estate property on the petition date. The check did not represent exempt life insurance but rather it still represented funds on deposit in Debtor's account that Debtor did not declare exempt. Therefore, the Trustee's objection to Debtor's claimed exemption in the Life Investor's policy will be sustained to the extent that the value of Debtor's policy was enhanced by the post-petition payments. The value of Debtor's exempt Life Investor's policy will be limited to its value on the petition date. *In re May*, 194 B.R. 853, 855 (Bankr. D.S.D. 1996) (a debtor's entitlement to exemptions and the value of exempt property is generally determined on the petition date).

Further, since the check to Life Investors was not honored pre-petition, there was no voidable preference under § 547(b). However, the check may be subject to avoidance by the Trustee under § 549(a). The Trustee will have to bring that action against Life Investors.⁵

As to the other checks written pre-petition and honored post-petition, it appears that the Trustee may also seek recovery for those transferred from the receiving creditors, again under § 549(a). Section 549(a), unlike the preference statute at § 547,

⁵ The *Steege* case also points out that the Trustee's cause of action for the post-petition transfer is against Life Investors unless the Bank had notice of the bankruptcy before it honored Debtor's check. 11 U.S.C. § 362(b)(11); *Steege*, 183 B.R. at 837.

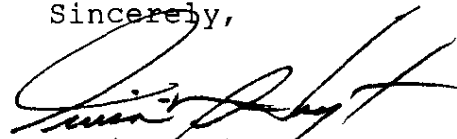
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has few exceptions. Debtor's bank will have no liability unless it knew of the bankruptcy before it honored the checks. See 11 U.S.C. § 542(c); *Wittman*, 167 B.R. at 664.

Finally, absent a showing of fraud, the Code does not seem to place responsibility on Debtor to return or replace the funds paid from his account post-petition based on pre-petition checks. See *In re Figueira*, 163 B.R. 192 (Bankr. D. Kan. 1993); compare *Maurer*, 140 B.R. at 746-47; *Lange*, 110 B.R. at 908-10. A turnover action under § 542 is commenced against the party having possession, custody, or control of the property. An action to avoid a post-petition transfer under § 549(a) and § 550 also contemplates relief against the transferee. Here, Debtor is no longer in possession or control of the bank funds that were transferred post petition. However, if the transfers were fraudulent, the Trustee's remedies against Debtor may include an objection to discharge under § 727(a). Other sections governing avoidance of fraudulent transfer may also come into play against the transferees.

An order will be entered sustaining the Trustee's objection to Debtor's claim of exemption in the Life Investor's policy to the extent of the post-petition payment of \$2,200.00. Debtor needs to immediately amend his schedules to include his interest in Nature Foods (or a similarly named entity) and the leaf blower that were omitted initially. The Trustee will then have thirty days thereafter to file an objection if any of those interests are declared exempt.

Sincerely,



Irvin N. Hoyt
Chief Bankruptcy Judge

INH:sh

cc: case file (docket original; copies to parties in interest)

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 in interest identified on the attached service list.

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

By:
Date: 3-7-97

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

MAR 07 1997

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

Case: 95-40644 Form id: 122 Ntc Date: 03/07/97 Off: 4 Page : 1

Total notices mailed: 4

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