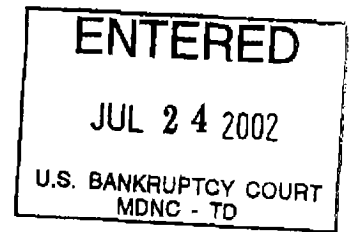


UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
WINSTON-SALEM DIVISION



IN RE:

ROBERT KEITH RAY and
DEBRA JANE CARPENTER
RAY

CASE NO. B-01-50948

Debtors

C. EDWIN ALLMAN, III, TRUSTEE
PLAINTIFF

vs.

ADVERSARY NO. A-01-6029

MICHAEL L. RIDDLE, TRUSTEE
HOMEFREE MORTGAGE COMPANY, LLC,
and KEY HOME EQUITY
DEFENDANTS

C. EDWIN ALLMAN, III, TRUSTEE
PLAINTIFF

vs.

ADVERSARY NO. A-01-6030

MICHAEL L. RIDDLE, TRUSTEE
HOMEFREE MORTGAGE COMPANY, LLC
and CONSECO FINANCE
DEFENDANTS

ORDER

THIS MATTER came on for hearing before the undersigned bankruptcy judge upon the Motion to Compromise and Settle the Adversary Proceedings filed by C. Edwin Allman, III, Trustee and Plaintiff, which provides for the settlement of all claims and counterclaim in this proceeding upon the payment by the Defendants of the sum of \$20,500.00 to the Trustee. In

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consideration for this payment, the Trustee agrees to consent to an order to be entered by the Court in this proceeding ordering that the first deed of trust and the second deed of trust (the "Deeds of Trust") be reformed to completely and correctly describe the Real Property, authorizing the recording of the Deeds of Trust and abandoning the real property. Counsel for the Debtors filed a response and asked that the Court approve this settlement only on the condition that the first \$20,000.00 of the proceeds be turned over to the Debtors upon receipt by the Trustee, or alternatively that a full hearing be conducted on the validity of the mortgage holders claims.

The Court has reviewed the entire official file and the briefs submitted by the parties and for the reasons stated herein, the Debtors' objection to the proposed settlement will be overruled and the Trustee's Motion to Compromise and Settle will be granted.

Background

The Debtors' filed a voluntary petition for relief under Title 11, Chapter 7 of the United States Bankruptcy Code on April 20, 2001. C. Edwin Allman, III was the duly appointed Chapter 7 Trustee. The Debtors' schedules reflected that they owned a residence at 5722 Candlewood Lane with a value of \$132,000 which was encumbered by two deeds of trust with a first deed of trust in favor of Key Homes and the second deed of trust in favor of Homefree Mortgage Company, LLC, which was subsequently assigned to Conseco, for total liens against the property in the amount of \$157,677.

The Debtors exempted their interest in the property but showed on the exemption form that there was no equity in the property. The Debtors then filed a Reaffirmation Agreement to their indebtedness to Key Homes and Conseco. The procedure in the Middle District is that all reaffirmations are reviewed by the court. The Court refused to authorize the Reaffirmation

Agreement in as much as the attached documents showed that Deeds of Trust were recorded in Forsyth County but described property located in Davidson County. The issues related to the Deeds of Trust were brought to the attention of the Trustee and counsel for the Debtor. As a result, it was determined that part of the property is located in Forsyth County and part of the property is located in Davidson County. The Deeds of Trust were filed in Forsyth County only, and describe only the portion of the property located in Davidson County. There are no Deeds of Trust filed in Davidson County. The Trustee commenced two adversary proceedings to avoid the liens on the real estate and to obtain a judicial determination that the property was free and clear of the liens.

Soon after the perfection issue came to light, the Debtors vacated the residence and the Trustee sought and obtained court permission to cause a sale of the real property with the liens to be transferred to the proceeds of sale. Prior to the actual sale being conducted, the Trustee reached an agreement with the first and second mortgage holders, primarily through the title insurance company, for the settlement of the Trustee's claims. The settlement would provide the Trustee with \$20,500.00, would effectuate a reformation of the Deeds of Trust to correct the description and recordation issues, and would result in the abandonment of the real property by the Trustee.

Issues

Whether the Debtors are entitled to claim an exemption in either the proceeds of the sale of the real property or the proceeds resulting from a settlement of the two adversaries; and whether the consideration for the settlement is sufficient.

Discussion

Section 522(g)(1)(A) of the Bankruptcy Code prevents the Debtors from claiming an

exemption in either the proceeds of the sale or the settlement proceeds. That section provides:

(G) Notwithstanding section 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.

All the parties agree that the Debtors have not concealed any transfers of property and also agree that this is not a transfer that the Debtors could avoid under subsection (f)(2) of this section. The open matter is whether this is a voluntary transfer.

When a trustee avoids a lien or settles an action to avoid a lien, the avoidance is for the benefit of the estate and the debtor is specifically prohibited from exempting that interest unless one of the limited exceptions of §522(g) is applicable. Here, the Debtors do not fall under the exceptions and are not entitled to exempt any of the proceeds recovered by the Trustee. The avoidance of a residential mortgage lien by a Chapter 7 trustee results in a benefit to the estate, and does not inure to the benefit of a debtor's exemption rights unless one of the limited exceptions applies. In re Berthea, 275 B.R. 127 (Bankr. D. D.C. 2002). A debtor is not entitled to exempt property which is recovered by a Trustee under § 551 when the debtor's transfer of the property was voluntary and the lien on such property could not have been avoided under section 522(f)(2). In re De Shong, 14 B.R. 179 (Bankr. D. De. 1981).

The granting of a deed of trust by a debtor is a voluntary transfer. See In re Romano, 175 B.R. 585 (Bankr. W.D. Pa. 1994) ("[I]f undertaking the larger transaction was within the debtor's control, any actions undertaken in consummating that transaction--even actions the debtor is loathe to take--must be regarded as voluntary."). Similarly, the granting of a security interest in

a vehicle to a bank and the notation of the lien on the title to the vehicle is a voluntary transfer by the debtor. In re Ulrich, 203 B.R. 691 (Bankr. C. D. Ill. 1997). In Ulrich the court stated:

The Debtor may not use Section(g)(1) to claim an exemption in the Ford Thunderbird because the Debtor's grant of a security interest in his vehicle to the Bank was a transfer of property as defined by 11 U.S.C. Section 101 (54). There was no evidence to suggest that the notation of the Bank's lien on the title to that vehicle was not a voluntary act by the Debtor. Moreover, the Debtor may not claim an exemption in the Thunderbird under Section 522(g)(2) because he could not have avoided the transfer under Section 522(f)(2).

In Re Ulrich 203 BR at 693. The Debtors maintain that the signing of a mortgage is not a voluntary act. In support of their position, the Debtors rely on In re McConville, 110 F.3d 47 (9th Cir. 1997). In McConville, the court held that the postpetition creation of a lien is not a transfer of property for the purposes of §549. This Court does not agree that McConville is applicable in this instance.

The Debtors voluntarily executed the notes and Deeds of Trust that encumber the property. The Deeds of Trust constitute consensual liens and cannot be defeated by the Debtors' exemptions. The only consensual liens that may be set aside under §522 are liens on (i) non possessory, nonpurchase money security interests in household furnishings, household goods which are used by the debtor's household or (ii) implements, professional books, or tools of the trade used by the debtor or dependent of the debtor or (iii) professionally prescribed health aids for the debtor or dependent of the debtor. The Deeds of Trust are not judicial liens, nor are they liens on personal property. The execution of the Deeds of Trust, like the execution on a security interest in a vehicle, is a voluntary transfer. Therefore, because the Debtors do not fall under any of the exceptions to §522(g), the avoided transfer is preserved for the benefit of the estate and the Debtors are not entitled to an exemption in the proceeds. See In re McQueen 25 B.R. 592 (Bankr. D.Vt. 1982) (Debtors are not entitled under 522(g) to any exemption in proceeds of preference

avoided by trustee where they voluntarily transferred property.)

In the matter before the court, the Trustee has filed a motion to settle the adversary proceeding with the creditor and the lien will not be avoided. This does not prohibit the Trustee from objecting to the Debtors' exemption. As stated in Ulrich, where a trustee has been instrumental in the recovery of the property, the trustee's action inures to the benefit of the estate and the debtors are not entitled to an exemption. Here, the Trustee will receive the sum of \$20,500.00 in settlement of his action against the mortgage holder. The Debtors may not exempt any on the recovered funds as the Debtors made a voluntary transfer to the mortgage holders. The Debtors do not fall under the limited exception of 522(g) to gain the benefit of the Trustee's avoidance and the estate is entitled to all the proceeds. In re Witt, 273 B.R. 573 (Bankr. W.D. Wis. 2000).

The Proposed Settlement

In determining whether to accept the sum of \$20,500, the Trustee has prepared a detailed analysis of the funds available in the event litigation proceeded and the Trustee prevailed on the merits. If the Trustee did prevail, then each mortgage holder would be entitled to file a deficiency claim in the case. As part of the settlement, the first mortgage holder has agreed not to file an unsecured claim in the case. If the settlement is approved, the expected dividend to the unsecured creditors is 22% and if the Trustee succeeds on the merits and the property were liquidated then the expected dividend to unsecured creditors would range from 25% to 35%.

The Court finds that the Trustee has exercised sound business judgment in negotiating a settlement that provides for the immediate payment to creditors without the further delay and cost of litigation and that the settlement is in the best interest of the estate.

Based on the foregoing, IT IS ORDERED, ADJUDGED AND DECREED THAT the Debtors' request to receive the first \$20,000.00 in settlement proceeds as exempt property is denied and it is further ordered that the Debtors' objection to the proposed settlement is overruled and the Settlement is approved.

This the 24 day of July, 2002.

CATHARINE R. CARRUTHERS

Catharine R. Carruthers
United States Bankruptcy Judge