United States Bankruptcy Court
Western District of Wisconsin

Cite as: [Unpublished]

Peter M. Gennrich, Trustee, Plaintiff, v.
Grand Marsh State Bank, Defendant
(In re Kathleen Yvonne Preib, Debtor)
Bankruptcy Case No. 96-30478-7; Adv. Case No. 96-3189-7

United States Bankruptcy Court
W.D. Wisconsin

July 1, 1997

Susan V. Kelley, Lee, Kilkelly, Paulson & Kabaker, S.C., Madison, WI, for plaintiff.
Tom Kubasta, Kubasta, Rathjen & Bickford, Wautoma, WI, for defendant.

Robert D. Martin, United States Bankruptcy Judge.

MEMORANDUM DECISION

This case is before the court on briefs. The parties stipulated to the following facts: On January 27, 1995, the debtor, Kathleen Preib, borrowed $14,304.87 from Grand Marsh State Bank. The documents executed in conjunction with that loan included a promissory note for $14,304.87, a truth in lending disclosure form, a mortgage, a consumer chattel security agreement for a mobile home on the premises and a disbursement sheet. On January 28, 1995, the parties signed and notarized the mortgage, but Grand Marsh did not record it until November 27, 1995 when the balance of the loan was $12,461.92. The market value of the property subject to the mortgage at all times exceeded the balance of the loan. On November 27, Ms. Preib was insolvent, and within 90 days thereafter, she filed bankruptcy. The unsecured creditors are not expected to receive anything in the distribution of Ms. Preib's bankruptcy estate.

The trustee seeks to avoid Grand Marsh's perfection of the mortgage as a preferential transfer under § 547(b). The parties agree that the perfection of the mortgage by recording on November 27, 1995 was a transfer as contemplated in § 547(b). Grand Marsh, however, defends as if the disbursement of the loan proceeds were the transfer at issue. The disbursement sheet shows that loan proceeds went to pay $172 in loan costs, $8,244.77 to retire a previous Grand Marsh mortgage (which was satisfied of record in July of 1995) and $1,104.87 to pay Modern National Life Insurance on a loan secured by an insurance policy. Thus, Grand Marsh argues $9,521.84 of the loan was "earmarked" for payment of those secured debts and did not diminish the bankruptcy estate. In the alternative, Grand Marsh argues § 522(g) protects its *in rem* security interest because Ms. Preib claimed property securing the mortgage under her homestead exemption, and it is not available to the trustee.

To recover a preferential transfer, the trustee must prove all elements of § 547(b):

Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property --

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made --

(A) on or within 90 days before the date of the filing of the petition; or

(B) between 90 days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if --

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 USC § 547(b). Grand Marsh received a transfer on account of an antecedent debt when it perfected within the preference period while the debtor was insolvent, thus the trustee has established the first four elements of § 547(b). The only disputed element is § 547(b)(5) -- whether the perfected mortgage gave Grand Marsh more in Chapter 7 than it would have had Grand Marsh never perfected.

I. Earmarking Defense

Some courts have concluded that:

When new funds are provided by [a] new creditor to or for the benefit of the debtor for the purpose of paying the obligation owed to [an] old creditor, the funds are said to be "earmarked" and the payment is held not to be a voidable preference.

In re Bohlen Enter., Ltd., 859 F.2d 561, 565 (8th Cir. 1988). Even if that were the controlling law in the present case, and Ms. Preib directed the application of the loan proceeds in January, she did not "earmark" her interest in the mortgaged real estate. That interest was never intended to be held or transferred to anyone other than Grand Marsh. Delivering the mortgage in January conveyed an equitable interest from Ms. Preib to Grand Marsh. That transfer was complete as between the parties. Grand Marsh may have remained a fully secured creditor by virtue of the terms of the prior mortgage until it was satisfied in July. Thereafter Grand Marsh held only an unperfected secured claim by virtue of its later mortgage. Perfection by recording in November made that mortgage effective against subsequent conveyances of or liens on the real estate and constituted a transfer under § 547. "Earmarking" has nothing to do with that latter transfer. Had Grand Marsh not recorded its mortgage, the trustee would have brought the real estate into the bankruptcy by virtue of § 544(a)[(1)] for the benefit of all creditors, and Grand Marsh would have been treated as an unsecured creditor receiving only a small percentage of its claim in the bankruptcy distribution rather than as the fully secured creditor it now claims to be. Thus, the requirement of § 547(b)(5) is established.

II. Involuntary Transfer

In a novel and equally unavailing effort, Grand Marsh argues its "full *in rem* security interests in [Ms. Preib's] property is preserved because [Ms. Preib] has claimed the property as exempt." (Defendant's Brief at p. 5). Grand Marsh's argument is predicated on the assumption that the debtor can exempt her encumbered real estate under § 522(g). However, to exempt property under § 522(g),[(2)] two conditions must be met. First, the debtor must have been able to exempt the property had the property not been transferred. Matter of Weis, 92 B.R. 816 (Bankr. W.D. Wis. 1988). Second, the transfer must have been involuntary and the debtor must not have concealed the property. Id. In the present case, the mortgaged property is Ms. Preib's homestead, and there is no allegation that she concealed that property. However, Grand Marsh has not proved that the mortgage was an involuntary transfer.

Grand Marsh concedes that under "ordinary circumstances" the execution of a mortgage is a voluntary transfer. However, Grand Marsh suggests this case is extraordinary because its own interest is at stake. Positing two separate transfers, one when Ms. Preib executed the mortgage papers and another when the mortgage was perfected, Grand Marsh says the first was voluntary while the second was not. Only the "involuntary" component is claimed relevant to § 522(g). "[E]ven if the Trustee is able to avoid any part of the transfer based on Section 547, Section 522 is still available to the debtor."

Grand Marsh has cited no reason or prior case suggesting why Ms. Preib's mortgage should be analyzed in its "component" parts under § 522(g). Ms. Preib intended Grand Marsh to be a secured creditor when she delivered the mortgage. There is no suggestion that she withheld her consent to its recording. Grand Marsh, for reasons of its own (if any) allowed an unusual length of time to pass between receiving the conveyance and recording it.

Section 522(g) is a "specific restriction on the debtor's power to exempt estate property." In the Matter of Wilson, 694 F.2d 236 (11th Cir. 1982). The debtor can exempt property that the trustee recovers only if the debtor involuntarily transferred it. Otherwise, "[a]llowing such exemption claims would give the debtor a windfall which would enable him to benefit from his own voluntary act." Matter of Lamping, 8 B.R. 709, 711 (Bankr. E.D. Wis. 1981). Thus, § 522(g) is concerned with whether a debtor voluntarily made the transfer, not whether a transferee, like Grand Marsh, perfected its interest when the property was transferred.

Grand Marsh does not allege that Ms. Preib was coerced or pressured into granting the mortgage. That transfer was voluntary. See In re Terry, 56 B.R. 538 (Bankr. D. Vt. 1986) (asking, for purposes of § 522(g), whether a transfer was made of the debtor's own volition, free from duress or force). "[T]ransfers of a security interest are voluntary transfers and are not subject to exemption claims by the debtor after the property is recovered by the trustee." Id.; accord In re Ulrich, 203 B.R. 691 (Bankr. C.D. Ill. 1997) (finding § 522(g) not available because debtor voluntarily granted security interest in his car); In the Matter of Mefford, 18 B.R. 853 (Bankr. S.D. Ind. 1982). Accordingly, Ms. Preib cannot exempt her homestead under § 522(g) as Grand Marsh assumed. The debtor retains no property interest on which Grand Marsh's "interest that is avoided as a preferential transfer will nevertheless survive as *in rem* liability of the Debtor's homestead property . . . ." (Defendant's Brief at 7).

Judgment may be entered in favor of the trustee.

END NOTES:

1. 11 USC § 544(a) provides in relevant part:

The trustee shall have, as of the commencement of the case, and without regard to any

knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by --

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists[.]

2. 11 USC § 522(g) provides:

Notwithstanding sections 550 and 551 . . . the debtor may exempt . . . property that the trustee recovers under section . . . 551 . . . 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[.]