

28 OCT 2004

UNITED STATES BANKRUPTCY COURT
 NORTHERN DISTRICT OF GEORGIA
 ATLANTA DIVISION

IN RE: : CASE NO. 03-96149
 :
 KEITH BROWN and VICTORIA BROWN, : CHAPTER 7
 :
 Debtors. : JUDGE MASSEY
 :

ORDER ON TRUSTEE'S OBJECTION TO CLAIMED EXEMPTION

Debtors Keith and Victoria Brown filed this Chapter 7 case on June 4, 2003 and their schedules on June 23, 2003. In the schedules, they disclosed their ownership of real property at 135 Glen Eagle Way, McDonough, Georgia (the "Property") and listed lien claims against the Property in excess of its value. Debtors listed as a second mortgage, a claim in the amount of \$200,000 held by Dwight Brown, who is Keith Brown's father. On Schedule C filed on June 23, 2003, they did not claim the Property as exempt.

On October 9, 2003, the Court entered an order granting the Chapter 7 Trustee's motion to sell the Property free and clear of liens and encumbrances with valid liens and encumbrances to attach to the proceeds. Thereafter, the Trustee closed a sale of the Property and has on hand funds remaining after disbursements to the holder of the first priority security deed and other encumbrances as to which there was no dispute. On February 26, 2004, Dwight Brown filed an unsecured proof of claim on Official Form 10 in the amount of \$156,900. In the section of the proof of claim for a description of the collateral, Mr. Brown wrote the words "Released - see Attach." One of the attachments was a copy of a letter to the Trustee dated January 18, 2004, in which Mr. Brown stated:

This letter is to confirm my desire to relinquish my secured position on the property at 135 Glen Eagle Way, McDonough, GA 30253. My desire to do this is

in the interest of moving, and concluding the bankruptcy process against my son, so that he may move on rebuilding his life. It is imperative that I remain an unsecured creditor, as proofed with the copies of checks that I supplied to the court.

On March 5, 2004, the Trustee filed adversary proceeding no. 04-6067, naming Dwight Brown as a defendant and seeking to avoid any lien or encumbrance on the Property arising by reason of a security deed given by Debtors to Dwight Brown recorded during the one year period preceding the petition date.

On July 1, 2004, Debtors amended Schedule C to claim the Property as exempt up to the maximum value of \$20,000.

On July 15, 2004, the Trustee moved for a default judgment against Dwight Brown in adversary proceeding no. 04-6067. The Court granted that motion in an order and judgment entered on September 10, 2004.

On July 28, 2004, the Trustee filed an objection to exemption of the Property claimed by Debtors.

The Court held a hearing on the Trustee's motion to disallow the claimed exemption on September 7, 2004. The Trustee contends that because section 551 of the Bankruptcy Code preserves the preferential transfer avoided in adversary proceeding no. 04-6067 for the benefit of the estate, there is no equity in the Property or the proceeds of its sale that Debtors may exempt.

Debtors contend that Dwight Brown released his lien in his proof of claim, making it unnecessary for the Trustee to avoid that lien.

The Trustee's objection is meritorious for the following reasons. Dwight Brown's notation on his proof of claim and the attached letter to the Trustee cannot be construed as anything more than an offer to release his claim to the proceeds of the sale of the Property.

If Dwight Brown's purported release of the lien were construed as effective rather than as a mere offer to release the lien, that release would be void because it would have violated the automatic stay. Once a bankruptcy case is commenced, property of the estate includes "any interest in property that the estate acquires after the commencement of the case." 11 U.S.C. § 541(a)(7). Upon the filing of a bankruptcy petition, the estate automatically acquires a cause of action to seek avoidance of voidable transfers and to preserve those transfers for the benefit of the estate. Any attempt to surrender or satisfy a voidable lien to thwart the ability of the trustee to pursue that cause of action would violate the automatic stay imposed by section 362(3) of the Bankruptcy Code restraining "any act . . . to exercise control over property of the estate" and would therefore be void as against the estate.

The Trustee has succeeded in avoiding Dwight Brown's lien and preserving it for the estate's benefit under sections 547(b) and 551 of the Bankruptcy Code, the effect of which was to exhaust any equity in the Property from which the claimed exemption could be paid.

A debtor may claim an exemption in property in which there is no equity above liens against that property. The effect of exempting property in a bankruptcy case, generally speaking, is to exclude that property from "property of the estate" to the extent of the amount of the claimed exemption and to insulate the exempted property from liability for prepetition debts. 11 U.S.C. § 522(b) and (c). Exemption affects neither unavowed liens against such property nor liens that, though avoided, are preserved under section 551 for the benefit of the estate. Hence, where a trustee sells property in which a debtor has claimed an exemption but the proceeds of sale are not sufficient to pay the liens against the property in full, the debtor would derive no benefit from the exemption.

The lien held by Dwight Brown was avoided but preserved for the estate's benefit in the judgment entered on September 10, 2004. The effect of the judgment was to preserve exclusively for the estate that portion of the sale proceeds that would have been paid to Dwight Brown if his lien had not been avoided. As explained in *In re Arzt*, 252 B.R. 138 (8th Cir. BAP 2000), "a bankruptcy trustee who avoids a transfer steps into the shoes of the transferee and acquires the same rights that the transferee held." *Id.* at 142 (footnote omitted). The Trustee has stepped into Dwight Brown's shoes and holds his lien claim Property in the amount of \$156,900 against the proceeds of sale of the Property; the remaining balance of the sale proceeds is only \$127,715.65. Thus, there are no funds left over from which Debtors' exemption could be paid.

Section 522(g)(1) of the Bankruptcy Code provides:

(g) Notwithstanding sections 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[.]

The converse of subsection (g)(1) is that a debtor may not exempt property recovered by the Trustee under section 551 if, as here, the debtor voluntarily made the avoided transfer. Nothing in section 522 otherwise enables Debtors to claim an exemption in the balance of the proceeds of sale, which the trustee in effect recovered by avoiding and preserving Dwight Brown's lien against the Property.

Accordingly, it is

ORDERED that the Trustee's objection to the claim of exemption in the 135 Glen Eagle Way, McDonough, Georgia property is GRANTED. Debtors have no exemptible interest in the balance of the proceeds of the sale of that property held by the Trustee.

This 26th day of October 2004.



JAMES E. MASSEY
U.S. BANKRUPTCY JUDGE