UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF OHIO

In Re:	)	
	)	**JUDGE RICHARD L. SPEER**
Russell/Marcela Swank	)	
	)	Case No. 02-3029
Debtor(s)	)	
	)	(Related Case: 01-32048)
Elizabeth A. Vaughan, Trustee	)	
	)	
Plaintiff(s)	)	
	)	
v.	)	
	)	
Conseco Inc., et al.	)	
	)	
Defendant(s)	)	

DECISION AND ORDER

This cause comes before the Court upon the Plaintiff/Trustee's Motion for Summary Judgment. In this Motion, the Trustee seeks a declaration that, as a matter of law, a debtor's homestead exemption does not apply to any funds generated when, in accordance with the strong-arm powers provided to a bankruptcy trustee under 11 U.S.C. § 544, a mortgage on a debtor's real property is avoided. The facts which give rise to this matter are not in dispute.

On April 6, 2001, the Debtors, Russell Swank and Marcela Swank (hereinafter referred to collectively as the "Debtors"), filed a petition in this Court for relief under Chapter 7 of the United States Bankruptcy Code. The Debtors disclosed in their bankruptcy schedules a residence valued at Fifty-five Thousand dollars ($55,000.00), against which existed two encumbrances: a first mortgage to Conseco in the amount of Forty-four Thousand Fifty-one and 84/100 dollars ($44,051.84); and

a second mortgage to Conseco in the amount of Ten Thousand Three Hundred Seventy-nine and 18/100 dollars ($10,379.18). These mortgages had been assigned to Conseco by an earlier mortgagee. Against their residence, the Debtors, as permitted by § 522, claimed two homestead exemptions totaling Ten Thousand dollars ($10,000.00). No objection to these claims of exemption was ever lodged by the Trustee.

On June 6, 2001, the Trustee, as required under § 341 of the Bankruptcy Code, conducted an examination of the Debtors' financial affairs. During this examination, it came to the Trustee's attention that certain irregularities may have occurred in the execution of both the first and second mortgages held by Conseco. As a result of these supposed irregularities, the Trustee, on February 5, 2002, commenced the instant adversary proceeding to avoid these mortgages in accordance with the strong-arm powers provided to a bankruptcy trustee under 11 U.S.C. § 544(a). Presently, the Trustee and Conseco are in negotiations to settle this claim.

LEGAL DISCUSSION

Pursuant to 28 U.S.C. § 157(b)(2)(B), the allowance or disallowance of an exemption is deemed a core proceeding over which this Court has the jurisdictional authority to enter final orders.

This cause comes before the Court upon the Plaintiff/Trustee's Motion for Summary Judgment. The standard for summary judgment is set forth in Fed.R.Civ.P. 56, which is made applicable to this proceeding by Bankruptcy Rule 7056, and provides for in pertinent part: A movant will prevail on a motion for summary judgment if, "the pleadings, depositions, answers to interrogatories, and admissions on file, together with affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." *Celotex Corp. v. Catrett*, 477 U.S. 317, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). In order to prevail, the movant must demonstrate all the elements of the cause of action. *R.E. Cruise, Inc. v. Bruggeman*,

508 F.2d 415, 416 (6th Cir.1975). Thereafter, upon the movant meeting this burden, the opposing party may not merely rest upon their pleading, but must instead set forth specific facts showing that there is a genuine issue for trial. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 250, 106 S.Ct. 2505, 2511, 91 L.Ed.2d 202 (1986). Inferences drawn from the underlying facts must be viewed in a light most favorable to the party opposing the motion. *Matsushita v. Zenith Radio Corp.*, 475 U.S. 574, 586-88, 106 S.Ct. 1348, 1356, 89 L.Ed.2d 538 (1986).

The Trustee in this adversary proceeding seeks, in accordance with the strong-arm powers provided to bankruptcy trustees under 11 U.S.C. § 544(a), to avoid the two mortgages held by Conseco against the Debtors' residence. In response to this action, the Debtors asserted a right to claim their homestead exemptions in any equity created if the mortgages are ultimately avoided. On these claims of exemption, the Trustee filed the instant Motion for Summary Judgment, arguing that when a mortgage interest is avoided under § 544(a), any and all of the equity created by such an action inures to the benefit of the bankruptcy trustee, and not to the debtor. Thus, the sole issue raised by the Trustee's Motion for Summary Judgment may be framed as this: When a bankruptcy trustee, in exercising their avoiding powers, creates equity in a debtor's property, is the debtor thereafter entitled to claim an exemption against the newly created equity?

Section 522(g) governs the issue presented in this case by providing that:

> 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; and
> >
> > (B) the debtor did not conceal such property[.]

Thus, this section, although not a prohibition, imposes two strict requirements on a debtor who seeks to claim an exemption in any equity created through the trustee exercising their avoiding powers: (1) the transfer must not have been voluntary; and (2) the debtor must not have made an attempt to conceal the transfer. The purpose for these requirements is to prevent a debtor from claiming an exemption in recovered property which was transferred in a manner which gave rise to the trustee's avoiding powers in the first place. *In re Glass*, 60 F.3d 565, 568-69 (9th Cir. 1995). As it pertains to the above restrictions, the question raised in this matter is whether, under the first requirement, the transfer of the Debtors' two mortgages were voluntary within the meaning of § 522(g).

By definition, a mortgage is a lien on real property which can only be created upon the written consent of the debtor/mortgagor. *Hembree v. Mid-America Fed. S. & L. Assn.*, 64 Ohio App.3d 144, at 151-152, 580 N.E.2d 1103 (1989). Thus, given the consensual nature of a mortgage lien, the transfer of such an interest is presumed to be voluntary for purposes of 522(g). *Trentman v. Meritech Mort. Serv., (In reTrentman)*, 278 B.R. 133 (Bankr. N.D.Ohio 2002). This presumption, however, may be overcome when the circumstances clearly show that the mortgage was not entered into of the mortgagor's free will. *Id*. at 136; *In re Taylor*, 8 B.R. 578, 580 (Bankr. E.D.Pa 1981). As it pertains thereto, the Debtors make what are essentially two supporting arguments, the merits of which will now be discussed, concerning the involuntary nature of their mortgage transactions.

The Debtors' first supporting argument can be termed an argument of adhesion because, in the words of the Debtors, they "had no choice but to grant the mortgage interest(s) if they wanted to obtain the refinancing of their house."(Doc. No. 22, at pg. 10). That is, "[t]hey had to sign or not get any funds." *Id*. These statements, however, while undoubtably true, merely set forth what is inherent in the nature of a mortgage: as a condition precedent for receiving financing, a person seized in real property agrees, in writing, to convey a mortgage interest to the financier. *See* BLACK'S LAW DICTIONARY 911 (5th ed. 1979); O.R.C. § 5301.01. Stated succinctly, all mortgage transactions involve some type of quid pro quo. Accordingly, even though a debtor would obviously prefer not

to convey a mortgage interest in their property to a creditor, it is difficult to discern how any mortgage, given its very innate qualities, could be considered involuntary merely because a creditor conditioned a loan transaction on the conveyance of a mortgage interest. Thus, for this reason, the Court must reject the Debtors' first argument.

The Debtors' second argument in support of the involuntary nature of their mortgages was stated to the Court as follows:

> [The Debtors] relied on the legality of the signing ceremony and the mortgage company certainly had knowledge as to the witnessing requirements. [The Debtors] had no knowledge of the formal requisites for a mortgage deed to be executed in the state of Ohio, and obviously, would not have signed the mortgage deed in favor of the [Creditor] if they had been told the mortgage deed about to be executed may be defective and that it was possible that they might lose their real estate exemption if a bankruptcy ensued, or even possibly may lose the ownership of such real properly completely and lose, as well, all the mortgage payments made after January 30, 1998, until several months after their date of bankruptcy (i.e. approximately three (3) years of monthly mortgage payments).

(Doc. No. 22, at pg. 12). In essence then, this second argument centers on the Debtors' lack of knowledge concerning potential execution defects that existed with their mortgages. There are, however, a couple of inherent weaknesses with this argument.

To begin with, whether a mortgage is properly executed does not affect the mortgagor's liability thereunder. Stated differently, a mortgagor gains no benefit by showing that a mortgage was defectively executed. This is because under Ohio law, unless a mortgage is so defectively executed so as to be void, an instrument intended as a mortgage, but not executed in accordance with the requisite statutory requirements, is still accorded the effect of a mortgage as between the Parties. *Seabrooke v. Garcia*, 7 Ohio App.3d 167, 169, 454 N.E.2d 961 (1982), *citing Citizens National Bank v. Denison*, 165 Ohio St. 89, 133 N.E.2d 329 (1956).

Instead, defects with the execution of a mortgage only effect the validity of the mortgage as it concerns third parties who otherwise would have had, vis-a-vis the mortgagee, a subordinated interest in the property; particular examples of otherwise subordinated interest include subsequent mortgages and subsequent bona fide purchasers. *Coshocton Nat'l Bank v. Hagans*, 40 Ohio App. 190, 191, 178 N.E. 330 (1931).Thus, as these points show, the protections afforded by the existence of a mortgage inure not to the benefit of the mortgagor, but rather to the mortgagee. As a result, it is highly questionable whether the Debtors in this case even have standing to raise issues concerning any potential defects which occurred in the execution of their mortgages.

Secondly, and closely related to the above, since it is the Creditor, and not the Debtors, which stands to lose its mortgage interests, there is simply no basis for this Court to conclude that the Debtors' lack of knowledge concerning the proper execution requirements for a mortgage was the result of any fraudulent conduct on the part of the Creditor. This lack of fraud is important because whether the transfer of a mortgage is involuntary under § 522(g) depends not on the mortgagor's lack of knowledge regarding essential facts relating to the mortgage, but rather whether the mortgagor was *intentionally mislead* as to an essential fact concerning the mortgage. *See In re Trentman*. 278 B.R. at 136.

The basis for this distinction was explained in Ohio Jurisprudence where, in addressing this issue in the context of a contract, it was stated:

> It is a general rule as to the binding effect of contracts that in the absence of fraud or mutual mistake, a party who executes a written contract cannot say that he was ignorant of its contents and thus escape liability. The party drawing the contract is under no obligation to state the terms thereof to the other party where the other party is able to contract. It is a well-established principle that it is the duty of every person who enters into a contract, to learn its contents before he signs it. A party cannot shut his eyes and sign a contract and then ask to be relieved from its plain terms merely because he did not

> know what it contained. Contracts would have little force and effect if they could be set aside upon such ground.

OHIO JUR. 3d, *Contracts*, § 18. Although the above only addresses the "terms" of a contract, as opposed to defects in the execution of a mortgage, this distinction is equally applicable here as a mortgage is, in essence, a contract, and thus generally subject to the same rules. *See, e.g.*, *F.D.I.C. v. Hennessee*, 996 F.2d 534 (10th Cir. 1992) (a mortgage is, in essence, a contract, and thus generally subject to the same rules).

Thus, for all the reasons stated above, the Court simply has no basis to conclude that the mortgages executed by the Debtors should not be considered voluntary for purposes of § 522(g). As a result, the Debtors may not rely on this section to claim an exemption in any equity created by the Trustee exercising her avoiding powers under § 544. Notwithstanding, the Debtors, in the alternative, have also raised additional arguments in support of their claim of a homestead exemption. The Court will now address each of these arguments individually.

First, the Debtors argue that because no timely objection was made, the Trustee is now time-barred from seeking to contest their claim of a homestead exemption. (Doc. No. 22, pg. 4). While the Court does not actually disagree with this statement, it misses the point – the Trustee is not actually seeking to object to the Debtors' homestead exemption, but is rather simply contesting the Debtors' ability to assert an exemption against any equity created by the Trustee exercising her avoiding under § 544. Thus, while the Debtors are entitled to their homestead exemption, it may only be applied, as just discussed above, against any equity in the Debtors' residence which is above and beyond any mortgages avoided by the Trustee.

Second, in support of their claim of a homestead exemption, the Debtors raise an equitable argument, relying on § 105(a).[1] At the base of this equitable argument is the Debtors' assertion that if they are not able to assert a homestead exemption in any equity created by the Trustee, their fresh-start will be compromised. As it concerns this argument, there is no doubt that some negative consequences may potentially befall the Debtors if either or both of the mortgages in this case are avoided by the Trustee. Of particular concern, the Debtors may lose their home if they cannot obtain other financing.

However, the fresh-start provided for by the Bankruptcy Code is not always without a price; of particular applicability, when a debtor voluntarily submits to the jurisdiction of this Court, the debtor relinquishes their rights in their nonexempt property to the extent that a trustee may utilize that property for the benefit of the debtor's unsecured creditors. In this regard, a few observations can be made. First, had the Debtors desired to keep their nonexempt property, bankruptcy relief should have been sought under Chapter 13 rather than Chapter 7, as the latter Chapter is appropriately entitled "Liquidation." Second, while most debtors expect to be able to reaffirm on a debt against fully encumbered property, the Bankruptcy Code makes no such guarantee. *In re Nikokyrakis*, 109 B.R. 260, 262 (Bankr. N.D.Ohio 1989). Finally, in a Chapter 7 bankruptcy, the heart of the fresh-start policy of the Bankruptcy Code is the bankruptcy discharge – which the Debtors have already received – and not the retention of one's encumbered property. *See, e.g., In re Bernier*, 282 B.R. 773, 780 (Bankr. D.Del 2002).

---

[1] This section provides that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process."

Moreover, even if this Court were inclined to exercise its equitable powers under § 105(a), such powers cannot be exercised in contradiction to the Bankruptcy Code. As stated by the Sixth Circuit Court of Appeals in *In re Highland Superstores, Inc.*:

> Bankruptcy courts simply do not have free rein to ignore a statute in the exercise of their equitable powers pursuant to 11 U.S.C. § 105. Whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code.

154 B.R. 573, 578-79 (6th Cir. 1998) (internal quotations omitted). Accordingly, as § 522(g) clearly proscribes the relief the Debtors seek, the Court cannot circumvent its prohibition by using the equitable powers provided for under § 105(a).

Finally, the Debtors argue that the Trustee's attempt to settle this matter with Conseco is not commensurate with the Trustee's duties to maximize the return to creditors under § 704. (Doc. 21, at pg. 2). This Court, however, has consistently afforded bankruptcy trustees a great deal of latitude in how they pursue their duties under the Bankruptcy Code. *In re Booth*, 266 B.R. 105, 111 (Bankr. N.D.Ohio 2000). As a result, in the absence of a showing of an abuse of discretion, the Court will not interfere with discretionary matters involving the liquidation of estate assets. In this case, therefore, since the Trustee clearly has many legitimate reasons for seeking to settle her claim against Conseco – e.g., cost of litigation, uncertainty as to outcome of the litigation as a result of the Debtors possibly being reluctant witnesses – the Court, in this case, will not interfere with the Trustee's judgment.

In conclusion then, the Court for all of the reasons stated herein, finds that the Debtors are not entitled to claim a homestead exemption in any equity created if the Trustee is ultimately successful in avoiding those mortgages now held by Conseco. As such, the Trustee's Motion for Summary Judgment will be Granted. In reaching the conclusions found herein, the Court has

considered all of the evidence, exhibits and arguments of counsel, regardless of whether or not they are specifically referred to in this Decision.

Accordingly, it is

ORDERED that the Motion for Summary Judgment submitted by the Plaintiff/Trustee, Elizabeth A. Vaughan, be, and is hereby, GRANTED.

Dated:

_____

Richard L. Speer
United States
Bankruptcy Judge