

In re Minter-Higgins

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QUESTIONS PRESENTED

Whether a Chapter 7 trustee can utilize a turnover motion to recover from a debtor funds that were transferred from the debtor's bank account post-petition as a result of the debtor issuing checks and initiating debit transfers before filing for bankruptcy that were not honored by the bank until after she filed the petition?

BRIEF ANSWERS

A Chapter 7 trustee cannot recover from the debtor, through a turnover motion, post-petition transfers that were made out of the debtor's bank account that resulted from pre-petition checks and debit expenditures that were not transferred by the bank to the payees until after the debtor filed for bankruptcy. The § 362(b)(11) exception from the automatic stay insulates a consumer debtor from the trustee's attempt to require her to "turnover" these amounts.

DISCUSSION

In 1984, § 362(b)(11) was added to the United States Code. *Roete v. Smith*, 936 F.2d 963, 966 (7th Cir. 1991). This section was intended by Congress to create an exception to the automatic stay produced by § 362(a). *Id.* The statute says that "[t]he filing of a petition . . . does not operate as a stay . . . under subsection (a) of this section, of the presentment of a negotiable

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instrument and the giving of notice of and protesting dishonor of such an instrument.” 11 U.S.C. § 362(b)(11) (2006). The House Judiciary Committee stated that “the automatic stay is not intended to interfere with the rights of a holder of a negotiable instrument to obtain payment.” H.R. REP. NO. 96-1195 (1980); *see Morgan Guaranty Trust Co. of New York v. American Sav. and Loan Ass’n*, 804 F.2d 1487, 1492 (9th Cir. 1986); *see also Roete*, 936 F.2d at 966. Even prior to this clarification by Congress, it was stated “that presentment of a negotiable instrument subsequent to the filing of a bankruptcy petition did not violate” the automatic stay. *See Morgan*, 804 F.2d at 1492; *see also In re Minter-Higgins*, 366 B.R. 880, 887 (Bankr. N.D. Ind. 2007).

Nevertheless, courts that have analyzed the issue of whether the debtor must turnover funds that were taken out of his bank account as a result of post-petition presentment have reached inconsistent and conflicting conclusions. For example, in *In re Pyatt*, the court denied the Trustee’s motion to compel turnover. *In re Pyatt*, 348 B.R. 783, (8th Cir. Bankr. App. Panel 2006). The court found that the debtor failed to report the actual amount in his bank account on the date of petition, which was one of his required duties. *Id.* at 785. Yet, the court ruled in favor of the debtor for three reasons. First, the court explained that the trustee could prevent transfers without having to face criminal liability. *Id.* at 786. The debtor, on the other hand, would risk prosecution for “writing a bad check.” *Id.* Second, the trustee is the only party authorized to recover post-petition transfers. *Id.* Third, considerations of “fundamental fairness” require that the funds be collected from the creditors who received the transfers rather than from the debtor. *Id.*

The court came to a similar conclusion in *In re Taylor*, 332 B.R. 609 (Bankr. W.D. Mo. 2005). Again, the debtor issued checks pre-petition that were not honored by the bank until after the debtor filed for bankruptcy. The trustee sought a turnover of the property which was in the

debtor's account when she filed her bankruptcy petition, which included the money used to pay the pre-petition transferees. The court "adopt[ed] the date of honoring rather than the date of delivery for purposes of determining the effective date of a transfer made by a check." *Id.* at 611. Therefore, the amount of the pre-petition checks that were not honored by the bank until after the debtor filed the petition "were property of the debtor's bankruptcy estate on the date of filing." *Id.* Nevertheless, the court held that the trustee could not compel turnover of the funds from the debtor. The court reasoned that upon the filing of a Chapter 7 bankruptcy petition, it is the responsibility of the trustee to "give the notices necessary to ensure that property of the estate is paid to the trustee." *Id.* at 612. Therefore, as long as the debtor made the proper disclosures on her petition, "the Trustee then had the responsibility to either notify the identified bank of the bankruptcy filing so that the bank no longer had the ability to honor outstanding checks post-petition, or to issue a stop payment on any outstanding checks." *Id.* at 613.

The court reached a contrary decision in *In re Dybalski*. *In re Dybalski*, 316 B.R. 312 (Bankr. S.D. Ind. 2004). There the petitioner's bank honored several checks that were issued by the debtor prior to filing for bankruptcy. The court stated that since the "[t]ransfers from the debtor's checking account occurred post-petition, the transferred [f]unds are, therefore, property of the estate." *Id.* at 316. The court acknowledges that this has the effect of making the debtor "pay the same 'bill' twice," but the court reasons that the result is fair because it is the debtor who has the responsibility of making sure that any checks he has issued are honored by the bank before he files for bankruptcy. *Id.* at 316–317.

Similarly, in *In re Sawyer*, 324 B.R. 115 (Bankr. Ariz. 2005), the court again faced the situation where a debtor wrote out checks pre-petition, which were not honored by the financial institution until post-petition. The court ruled in favor of the Chapter 7 trustee and ordered

turnover of the funds. In reaching its decision, the court first reasoned that 11 U.S.C. § 362(b)(11) applies “only to those third parties which engage in transactions with the debtor.” *Id.* at 121. The court explains, for example, that if a bank does not have knowledge that the debtor filed for bankruptcy, and subsequently transferred property of the estate, as long as the transfer was made in good faith, the bank will be protected. *Id.* The court then stated that under 11 U.S.C. § 541(a), the funds were property of the bankruptcy estate. *Id.* The court also found that, although the debtor did not have custody of the funds, she did have control over the funds because the bank “had not authorized, as a payor bank, any final payment on the checks that the Debtors had sent out by mail.” *Id.* Based on this reasoning, the court found that the debtor was required to turn over the funds. Although the court expressed discontent with this outcome, it maintained the result and suggested that the debtor could avoid this consequence by using her debit card rather than issuing checks. *Id.* at 124 (explaining that “it concerns this Court that this Decision now requires a debtor in Arizona to wait until all checks have been honored . . . before filing a petition . . . [but] the Court sees not alternative to such a requirement.”).

Another United State Bankruptcy Court was recently faced with the same issue in *In re Minter-Higgins*. 366 B.R. 880 (Bankr. N.D. Ind. 2007). The court, in *Minter-Higgins*, rejected the reasoning of the cases above in holding that the debtor was not required to turnover the funds. *Id.* at 887.

I. Factual and Procedural History of *In re Minter Higgins*

The amount in dispute in *In re Minter Higgins*, \$383.13, was a rather insubstantial amount, however, the conclusive settlement of the question posed to the court could have a substantial effect on the rights and obligations of both parties to a bankruptcy proceeding. Prior to filing for Chapter 7 bankruptcy, the debtor used checks and debit transfers to make \$383.13

worth of expenditures. This money was used to pay for groceries, and gasoline. The debtor also made a credit card payment with the money and a donation to her church. The court classified these as “ordinary transactions.” *In re Minter-Higgins*, 366 B.R. 880, 886 (Bankr. N.D. Ind. 2007). Due to regular delay, however, the funds to pay for these expenditures “were not transferred to the payees of those checks until after the date of the filing of the petition.” *Id.* at 882–883. Consequently, it was unclear whether those funds should be considered part of the debtor’s estate.

The Chapter 7 trustee made a motion to have the debtor turnover the funds that were held in her bank account when she filed her bankruptcy petition. A hearing was held on the motion, at which time the debtor objected to the turnover. The court denied the trustee’s motion. On November 22, 2006, the Chapter 7 trustee filed a motion to alter or amend the prior judgment.

II. The Argument of the Chapter 7 Trustee

The Chapter 7 trustee argued that all the “funds on deposit in the debtor’s account on the date of her filing her petition constituted property of the debtor’s Chapter 7 bankruptcy estate.” *In re Minter-Higgins*, 366 B.R. 880, 882 (Bankr. N.D. Ind. 2007). Relying on *In re USA Diversified Products, Inc.*, 100 F.3d 53 (7th Cir. 1996), the trustee further alleges that all the “outstanding checks or debit requests [that] were not transferred to the payees of those checks until after the date of the filing of the petition . . . [remain] property of the debtor’s Chapter 7 estate [and are thus] subject to turnover by the debtor.” *Minter-Higgins*, 366 B.R. at 882–883. Furthermore, the trustee argued that under 11 U.S.C. § 542(a) he could “require delivery of ‘property or the value of such property’.” *Id.* at 884. Therefore, he claims that he can “obtain the value of transferred property even if the target of the turnover order is no longer in possession of that property.” *Id.*

III. The Debtor's Argument

Alternatively, the debtor argued that because the check and debit expenditures “were outstanding and ha[d] not yet been finally charged to her account on the date of the filing of her petition, the amount of her ...[account] on the date of the filing of her petition should be diminished by these items.” *In re Minter-Higgins*, 366 B.R. 880, 882 (Bankr. N.D. Ind. 2007). Consequently, the debtor argues that the Trustee's turn over motion should be denied.

IV. The Court's Ruling

The court rejected the reasoning of both parties and ultimately resorted to the concept of fundamental fairness in reaching its decision that the debtor should not be required to turnover the funds. Initially, the court considered whether the trustee could recover from the bank or from the transferees of the negotiable instruments. In both instances, the court reasoned that this would not be possible.

It is conceivable that the trustee could have sought turnover from the bank since 11 U.S.C. § 542(b) provides that “an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to... the trustee.” The court held, however, that it was proper for the trustee not to seek recovery from the bank. *In re Minter-Higgins*, 366 B.R. 880, 883 (Bankr. N.D. Ind. 2007) The court said that 11 U.S.C. § 542(c) insulated the bank since “there is no evidence that that entity had either actual notice or actual knowledge of the commencement of the debtor's case.” *Id.* Where a financial institution does not have knowledge of the commencement of the case, it will not be liable if it “transfer[s] property of the estate, or pays a debt owing to the debtor, in good faith.” 11 U.S.C. § 542(b) (1994); *Minter-Higgins*, 336 B.R. at 883.

The court also found that the trustee would not be able to recover from the payees of the

check and debit expenditures. *Id.* The trustee could not utilize preference recovery under 11 U.S.C. § 547(b) because “that section requires the transfer to be made on the date of the filing of the petition or within a specified period prior to that date.” *Id.* Since the transfers in this case did not occur until after the debtor filed her petition, the trustee cannot utilize preference recovery.

Similarly, the trustee would fail to recover from the payees under 11 U.S.C. § 549(a). This section provides that “the trustee may avoid a transfer of property of the estate- (1) that occurs after the commencement of the case.” 11 U.S.C. § 549(a) (1994); *Minter-Higgins*, 366 B.R. at 883. Nevertheless the court stated that “11 U.S.C. § 349(a)(2)(b) precludes recovery of post petition transactions if they are authorized by either Title 11 of the United States Code or by the Court.” *Id.* Here, the transaction was authorized by 11 U.S.C. § 362(b)(11), which excepted the presentment of the negotiable instruments from the automatic stay. 11 U.S.C. § 362(b)(11) states that “‘the presentment of a negotiable instrument and the giving of notice of and protesting dishonor of such an instrument’ do not violate the automatic stay.” 11 U.S.C. § 362(b)(11) (2006); *Minter-Higgins*, 366 B.R. at 883. Therefore, the trustee could not recover the money from the transferees.

Thus, the trustee was limited to seeking recovery from the debtor who was no longer in possession of the transferred funds. First the court had to determine whether the funds in question were part of the debtor’s estate. The court, under 11 U.S.C. § 541(a), adopted an extremely broad understanding of what constitutes the debtor’s estate. Essentially “all legal or equitable interests of the debtor in property as of the commencement of the case,” are considered part of the estate. *Id.* at 885. The court strictly applied the statute, and therefore found that because the \$383.13 was in the debtor’s account at the time the proceeding was commenced, it was considered property of the estate. *Id.*

While the funds were considered part of the debtor's estate, the court determined that they were not recoverable from the debtor. The court's determination was based on the principle of fundamental fairness. The court bases its unfairness rationale on four grounds.

First, the court explains that there is "an inherent unfairness... in having the debtor pay back something to the trustee that the trustee can't recover from transferees." *Minter-Higgins*, 366 B.R. at 887. The court considered the fact that in nearly every other case, the trustee tries to recover from the transferee, rather than the debtor. *Id.* at 885. The reason that recovery is sought from the transferee is so that the debtor does not end up having to pay twice. Here, the trustee is seeking recovery from the debtor since he cannot recover from the payees. The court said that the law is not so "unfair" that it would allow such recovery. *Id.* at 886.

Second, the debtor cannot control the presentment of a check. *Id.* at 887. It would be unfair to hold the debtor liable for delays by the bank where the debtor would not be liable had the bank acted in a timely fashion.

Third, although prior court decisions have put forward methods which the debtor could utilize to avoid double paying, these methods are "not... viable alternatives." *Id.* at 888; *see also in re Dybalski*, 316 B.R. 312, 317 (Bankr. S.D. Ind. 2004) (explaining methods the debtor could use to avoid double paying). For example, the debtor could wait until all checks have cleared before filing his bankruptcy petition. *Id.* Or, the debtor could use cashier checks if he expects that he will soon be declaring bankruptcy. *Id.* The court rejected these alternatives because they could result in a prolonged waiting period. The court also rejected these approaches because lawyers may not be aware that these issues could arise and thus will not advise their clients to follow these alternative methods. *Minter-Higgins*, 366 B.R. at 888.

Fourth, if debtors were required to double pay under these circumstances, it would

actually have an even more detrimental effect on creditors. Requiring the debtor to pay twice will “encourage persons in difficult financial circumstances not to pay debts . . . so that the amounts of those debts paid by the use of negotiable instruments do not have to be repaid to the trustee after the checks are cashed.” *Id.*

Seeking statutory support for its findings, the court relied on 11 U.S.C. § 362(b)(11). The court stated that this section “excepts the presentment of a negotiable instrument for payment from the operation of the automatic stay” *Id.* at 886; thus the court says that although “[t]he post petition final honoring of payment on a negotiable instrument ipso facto diminishes property of the estate . . . that diminishment has been specifically authorized by Congressional enactment.” *Id.*

CONCLUSION

A Chapter 7 trustee cannot utilize a turnover motion to recover from a debtor post-petition transfers from the debtor’s bank account that resulted from pre-petition checks and debit expenditures.

