UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

DONALD W. CROZIER, Case No. 87-81-C
SHIRLEY M. CROZIER,
Engaged in Farming, Chapter 7

Debtors.

ORDER ON OBJECTION TO EXEMPTIONS

On February 17, 1988 an objection to exemptions filed on behalf of the Mingo Trust and Savings Bank came on for hearing before this court in Des Moines, Iowa. Bruce J. Nuzum appeared on behalf of the Mingo Trust and Savings Bank (Bank) and Mark S. Lorence appeared on behalf of the debtors. At the close of the hearing the parties were given two weeks to submit briefs. The matter was considered fully submitted on March 14, 1988.

Facts

The debtors filed a petition for relief under Chapter 7 of the Bankruptcy Code on January 12, 1987. Listed on their schedule of assets are the following interests in insurance policies:

INSURANCE CO.	POLICY NO.	DATE ISSUED	FACE AMOUNT	CASH VALUE
Inter-State	00209380	3/26/86	$30,000.00	$10,000.00
Inter-State	00209182	5/l/86	40,000.00	20,000.00
Principal Mutual	131960132	10/24/60	5,000.00	Unknown
Bankers Life	1727632	10/26/55	30,000.00	24,741.58
Bankers Life	1960137	10/24/60	5,000.00	4,659.48
Bankers Life	2809950	1/13/76	5,000.00	1,357.28
Bankers Life	31109664	7/23/79	20,000.00	3,308.07
Bankers Life	RE 2064920	11/22/63	10,000.00	4,056.36.
Bankers Life	2064921	11/22/63	10,000.00	3,586.99
	TOTAL			$71,709.76

On June 30, 1987 the debtors amended their schedules to claim the above insurance policies exempt under Iowa Code section 627.6(6). The Bank filed an objection to the claim of exemptions in life insurance on July 27, 1987,on the ground that the debtors bought such insurance on the eve of bankruptcy with the intent to defraud creditors.

At the time of the hearing on February 17, 1988, counsel for the Bank expressed difficulty in obtaining certain information and requested documentation from the debtors. He stated that the Bank had attempted to subpeona Donald Crozier to appear at the hearing but discovered that he was in Florida and had possession of most of the records in question. Counsel for the debtors stated that the insurance policies purchased in 1986 were purchased solely with funds provided by Shirley Crozier and thus he believed that she was solely competent to testify. Both counsel agreed that only the policies purchased in 1986 and the repayment on a loan from a 1955 policy were the subject of the Bank's objection.

Shirley Crozier testified at the February 17, 1988 hearing that she received approximately $76,000.00 prior to 1983 from her uncle Walter Van Cleve. These funds were used by the debtors on March 26, 1986 and May 1, 1986 to purchase life insurance policies with a total cash value of $30,000.00. She explained that the remaining $46,000.00 was used to purchase a real estate office from the Nevins in 1984 and a mobile home for her son in 1983. She also testified that she and her husband sold an apartment house in Newton, Iowa

on May 9, 1986 to her sister and brother-in-law for $20,000.00. With that money the debtors repaid a loan against a 1955 insurance policy in the amount of $14,283.32.

Counsel for the Bank introduced certified copies of original notices to a foreclosure action in Jasper County which indicated that the debtors had notice of a lawsuit and cross-claim against them on April 23, 1986 and on April 30, 1986. The Bank's counsel also introduced copies of recorded deeds dated May 6, 1986 and May 16, 1986 as well as a copy of the debtors' agreement to purchase the real estate brokerage business dated August 31, 1984.

Discussion

The Bank originally objected to the debtors' claim of exemptions asserting that the debtors bought insurance on the eve of bankruptcy with the intent to defraud creditors. In its brief filed on March 2, 1988 the Bank asserted that its objections were made pursuant to 11 U.S.C. section 548(a)(1), which provides:

> (a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily--
>
> > (1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; ....

The Bank's reliance on section 548(a)(1) is misplaced. The power to avoid fraudulent transfers rests with the trustee or a debtor-in-possession. Individual creditors generally have no right to institute such an action except through the trustee or debtor-in-possession. In re Curry and Sorensen, Inc., 57 B.R. 824, 827 (Bankr. 9th Cir. 1986). Accordingly, the court will view the Bank's objection as it was originally cast.

The debtors claim the life insurance policies exempt under Iowa Code section 627.6(6) which provides that a debtor may hold exempt from execution "[a]ny unmatured life insurance policy owned by the debtor, other than a credit life insurance contract". The Bank's original objection to exemptions and its statements at the hearing did not include a claim that the policies are "unmatured". The Bank first asked the court to assume that the policies were "matured" in its brief filed on March 2, 1988 due to the fact that the debtors failed to produce the policies for examination.

A creditor may file objections to the list of property claimed as exempt within 30 days after the first meeting of creditors or after the filing of an amendment to the list of property claimed as exempt. Fed. R. Bankr. P. 4003(b). The Bank filed an objection based upon the contention that the debtors converted nonexempt assets into exempt assets on the eve of bankruptcy with the intent to defraud creditors. No objection regarding the nature of the insurance policies was timely made. Accordingly, the Bank waived the right to

assert an objection on this ground. In any event, the debtors' insurance policies would fall within the definition of "unmatured life insurance policy" as stated in In re O'Brien, 67 B.R. 317 (Bankr. N.D. Iowa 1986).

The party objecting to the debtors' claim of exemptions has the burden of proving the exemptions are not properly claimed. Fed. R. Bankr. P. 4003(c). As a general rule, the conversion of nonexempt property into exempt property on the eve of bankruptcy is not inherently fraudulent. The legislative history of the Code reveals that Congress intended that debtors be allowed to convert property to utilize fully exemptions. The House and Senate reports state:

> As under current law, the debtor will be permitted to convert nonexempt property into exempt property before filing a bankruptcy petition. The practice is not fraudulent as to creditors, and permits the debtor to make full use of the exemptions to which he is entitled under the
> law.

H.R. Rep. No. 595, 95th Cong., lst Sess. 361, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6317; S. Rep. No. 989, 95th Cong., Ist Sess. 76, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5862. The Eighth Circuit has likewise recognized that a debtor may make full use of exemptions by converting nonexempt assets into exempt property. McCormick v. Security State Bank, 822 F.2d 806, 807, n. 2 (8th Cir. 1987); In re Lindberg, 735 F.2d 1087, 1090 (8th Cir. 1984).

Although the conversion of non-exempt property into

exempt property on the eve of bankruptcy is not in and of itself fraudulent, bankruptcy courts do examine the circumstances surrounding such conversion in adversary proceedings relating to discharge and dischargeability of debts. However, courts also consider a debtor's motives and actions in obtaining exempt property on the eve of bankruptcy in the context of contested claims of exemptions. In re Butts, 45 B.R. 34 (Bankr. D. N.D. 1984); In re Olson, 45 B.R. 501 (Bankr. D. Minn. 1984); In re Hall, 31 B.R. 42 (Bankr. E.D. Tenn. 1983). Extrinsic facts and circumstances must be in evidence to prove that the conversion of assets was done with fraudulent intent. In re Butts, 45 B.R. at 37 citing In re Johnson, 8 B.R. 650, 654 (Bankr. D. S.D. 1981).

The extrinsic facts and circumstances relied upon by the Bank are summarized in its brief. The Bank asserts that the debtors transferred $30,000.00 of non-exempt cash assets into two new life insurance policies in 1986 at a time when two foreclosure actions were pending or threatened and when they already had seven other policies in force. The Bank also contends that the debtors sold an apartment house for less than adequate consideration and used the proceeds to repay a policy loan on one of the older insurance policies. The Bank maintains that this repayment was not disclosed on the debtors' schedules and constitutes a preference. The Bank also cites as additional evidence of fraudulent intent the debtors' sale of certain real estate in December of 1986 and the debtors' failure to list certain property on their

schedules.

After consideration of the documentary evidence and the testimony, the court cannot conclude that the above circumstances either individually or taken as a whole establish that assets were converted with an intent to defraud creditors--at least on the part of Shirley Crozier. First, the bulk of the challenged transactions took place over eight months prior to the bankruptcy filing. The fact that a foreclosure action was pending or threatened near the time of the purchase of insurance is outweighed by Shirley Crozier's credible testimony that her husband's insurance application was "in the works" prior to the filing of the foreclosure action. The existence of the other policies at the time of the purchase is not persuasive. Moreover, Bank exhibit number 6 indicated that the debtors would obtain $50,000 in life insurance as part of the agreement for sale and purchase of the real estate brokerage business in 1984.

Second, the Bank's assertion that the debtors' sale of their apartment house was for less than adequate consideration is not convincing. The Bank failed to introduce evidence establishing that the property was worth more than the $20,000 received. The debtor's testimony that she thought it should be worth more and that a higher oral offer had been made does not satisfy the Bank's burden to prove fraudulent intent. The use of the sale proceeds to repay a loan on an older insurance policy likewise does not signal

fraud for purposes of disallowing an exemption. The failure to disclose the repayment on schedules and the potential preferential nature of the transaction could be the subject of an objection to discharge or a trustee's section 547 action but have little probative value in the context of a creditor's objection to exemptions.

Finally, the Bank's references to the sale of real estate in December of 1986 and to the debtors' failure to list certain assets on their schedules do not convince the court of the debtors' fraudulent intent. At the February 17, 1988 hearing Shirley Crozier testified that she had no knowledge of the property in question but believed the sale was probably made through the real estate office run by her husband. The personal property items identified by the Bank were indeed disclosed by the debtors on their inventory filed with the bankruptcy schedules. She also testified that there was no documentation of alleged debt owed to the debtors by their sons.

The totality of the extrinsic facts and circumstances relied upon by the Bank to establish fraud does not satisfy the Bank's burden of proof. Although the court finds that the testimony of Mrs. Crozier was sufficient to rebut the Bank's allegations, the court cannot condone the debtors' failure to respond to the Bank's motion to produce. The record reflects that Shirley Crozier made a reasonable effort to comply with the request. Donald Crozier did not. Indeed he frustrated the discovery efforts of the Bank and

failed to appear at the hearing. There is some reason to suspect that the record may have developed differently if the Bank had access to all the relevant evidence and could have examined Donald Crozier at the hearing. Based on the equitable powers granted bankruptcy courts, the Bank's objection to exemption will be sustained as to Donald
Crozier.

WHEREFORE based on the foregoing analysis, the court finds that the Mingo Trust and Savings Bank has failed to establish that the debtors' act of converting nonexempt assets into exempt assets was committed with fraudulent intent. The court further finds that equity mandates that the objection be sustained as to Donald Crozier.

THEREFORE, the Bank's objection to exemptions is hereby overruled as to Shirley Crozier and sustained as to Donald Crozier.

Signed and dated this 16th day of May, 1988.

LEE M. JACKWIG

CHIEF U.S. BANKRUPTCY JUDGE

Place behind Decision #118
in Decision Book.

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF IOWA
CENTRAL DIVISION

IN RE DONALD W. CROZIER and
SHIRLEY M. CROZIER,

Debtors.

CIVIL NO. 88-1306-B

MEMORANDUM OPINION,
AFRIRMANCE ON ONE APPEAL,
AND LIMITED REMAND ON THE
OTHER APPEAL

Debtors Donald W. Crozier and Shirley M. Crozier petitioned for relief under Bankruptcy Code Chapter Seven. See In re Crozier, No. 87-18-C (Bankr. S.D. Iowa May 16, 1988). After they received a discharge, they amended their petition to claim life insurance policy exemptions. Contending that the Croziers converted assets with intent to defraud creditors, creditor Mingo Trust and Savings Bank objected to an exemption for a 1955 policy, on which the Croziers had recently repaid a loan, and to exemptions for two policies they obtained the year before declaring bankruptcy.

After the bank deposed the Croziers on the exemption issue, they stipulated they would produce certain documents. When they failed to produce the documents, the bank served them with a Motion for Production of Documents, to which they did not respond. on the day before the evidentiary hearing on the bank's objection to the exemptions, the bank tried to serve the Croziers with subpoenas duces tecum. It served only Shirley, who attended the hearing and brought some of the documents; Donald appeared at the hearing by counsel but not in person.

On the bank's objection to exemptions, the bankruptcy judge, after discussing the facts and the law relating to the issues concluded:

> The totality of the extrinsic facts and circumstances relied upon by the Bank to establish fraud does not satisfy the Bank's burden of proof. Although the court finds that the testimony of Mrs. Crozier was sufficient to rebut the Bank's allegations, the court cannot

condone the debtors' failure to

respond to the Bank's motion to produce. The record reflects that Shirley Crozier made a reasonable effort to comply with the request. Donald Crozier did not. Indeed he frustrated the discovery efforts of the Bank and failed to appear at the hearing. There is some reason to suspect that the record may have developed differently if the Bank had access to all the relevant evidence and could have examined Donald Crozier at the hearing. Based on the equitable powers granted the bankruptcy courts, the Bank's objection to exemption will be sustained as to Donald Crozier.

WHEREFORE based on the foregoing analysis, the court finds that the Mingo Trust and Savings Bank has failed to establish that the debtors' act of converting nonexempt assets into exempt assets was committed with fraudulent intent. The court further finds that equity mandates that the objection be sustained as to Donald Crozier.

THEREFORE, the Bank's objection to exemptions is hereby overruled as to Shirley Crozier and sustained as to Donald Crozier.

Both Donald Crozier and the bank appeal.

THE BANK'S APPEAL

The bank had the burden of proving the exemptions improper. See Fed. R. Bankr. P. 40003(c). Even on the eve of bankruptcy, a debtor may fully use exemptions by converting nonexempt property to exempt. McCormick v. Security State Bank, 822 F.2d 806, 807 n.2 (8th Cir. 1987). The bankruptcy court's finding that the bank failed to show fraud was not clearly erroneous.

DONALD CROZIER'S APPEAL

Donald Crozier argues that the bankruptcy judge improperly defaulted him as a sanction. The bank argues that the bankruptcy judge properly found fraud from the badge of his improper behavior. It is not entirely clear to me on what basis the bankruptcy judge sustained the bank's objections as to Donald. The judge found that the bank had failed to satisfy its burden of proof, but sustained its objection as to Donald as an exercise of the court's "equitable powers," apparently because she found he "frustrated the discovery efforts of the Bank and failed to appear at the hearing."

Donald appeared at the hearing by counsel. Neither the bankruptcy judge nor the bank suggests why he was legally obliged to appear in person. Thus, -the record presented on appeal does not disclose a basis for default of Donald if the bankruptcy judge's decision was predicated on a default theory. Furthermore, default is a drastic sanction that is "only appropriate where there has been a clear record of delay or contumacious conduct," Taylor v. City of Ballwin, Mo., 859 F.2d 1330, 1332 (8th Cir. 1988) (quoting E.F. Hutton & Co. v. Moffatt, 460 F.2d 284, 285 (5th Cir. 1972)), and prejudice to creditors that cannot otherwise be remedied. See In re Rubin, 769 F.2d 611, 617-19 (9th Cir. 1985). The bankruptcy court found neither delay nor contumacious conduct; it did not find prejudice that other sanctions could not remedy.

If the bankruptcy judge sustained the bank's objection as to Donald as a sanction for not making discovery, she appears to have done so without compliance with the applicable discovery sanction rules. Fed. R. Civ. P. 37 provides the remedy for failure to afford discovery. See Gardiner v. A.H. Robins Co., Inc., 747 F.2d 1180, 1193 (8th Cir. 1984). The rule provides for sanctions only on motion. See Fed. R. Civ. P. 37(d). The record does not disclose that the bank moved for sanctions. Also, the record does not disclose that Donald had any notice and opportunity for any kind of hearing, to which he would be entitled. See Rubin, 769 F.2d at 616-17 (9th Cir. 1985); Gardiner, 747 F.2d at 1183, 1191, 1193.

This case must be remanded for clarification of the basis of the ruling as to Donald. .

AFFIRMANCE AND REMAND

The bankruptcy judge's overruling of the bank's objections as to Shirley Crozier is AFFIRMED.

In respect to the matter appealed by Donald Crozier, IT IS ORDERED that the case be remanded to the bankruptcy court for the limited purpose of Judge Jackwig's clarifying the basis of her ruling. Judge Jackwig shall, without unreasonable delay,

make such clarification and certify the same to this court, and this court will then rule on Donald Crozier's appeal.

DATED this_____day of June, 1989.

HAROLD D. VIETOR, Chief Judge

Southern District of Iowa

Place behind Decision #118
in Decision Book.

UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF IOWA

In the Matter of

DONALD W. CROZIER, Case No. 87-081-C
SHIRLEY M. CROZIER,

Debtors.

CLARIFICATION PURSUANT TO LIMITED REMAND
IN CIVIL NO. 88-13-6-B

On June 8, 1989 the Honorable Harold D. Vietor, Chief Judge of the United States District Court for the Southern District of Iowa, entered a memorandum opinion, affirmance of one appeal, and limited remand on the other appeal in In re Crozier, Civil No. 88-1306-B, an appeal from the undersigned bankruptcy judge's final order on objection to exemptions entered on May 16, 1988 in the above captioned Chapter 7 case. The district court opinion was filed in the bankruptcy court on June 12, 1989.

Judge Vietor questions the basis upon which I employed equitable powers in sustaining the bank's objection as to Donald Crozier after overruling its objection as to Shirley Crozier. The district court ponders the possibility that I either relied upon a default theory or was imposing sanctions for a failure to make discovery. After affirming my ruling as to Shirley Crozier's claim of an exemption, Judge Vietor states:

> In respect to the matter appealed by Donald Crozier, IT IS ORDERED that the case be remanded to the bankruptcy court for the limited purpose of Judge Jackwig's clarifying the basis of her ruling. Judge Jackwig shall, without unreasonable delay, make such clarification and certify the same to this court, and this court will then rule on Donald Crozier's appeal.

I have reviewed the May 16, 1988 order on objection to exemptions, the transcript of the February 17, 1988 hearing and the relevant and material portions of the court file. In respectful response to Judge Vietor, I state that the favorable ruling for Shirley Crozier and the unfavorable ruling for Donald Crozier were rendered in a consolidated fashion and in an effort to be as fair as possible to all parties under the circumstances.

Although the party objecting to the claim of exemption carries the burden of proof pursuant to Fed. R. Bankr. P. 4003(c), the standard of proof is far from that of the clear and convincing evidence test required when objecting to a debtor's discharge or when claiming a debt to be nondischargeable. However, as is often the case in those adversary proceedings, the contested matter under consideration turns on the question of the debtors' actual intent to defraud their creditors. Hanson v. First Nat. Bank in Brookings., 848 P.2d 866 (8th Cir. 1988). In the typical case the party trying to establish intent finds it necessary to rely on extrinsic or circumstantial evidence. In

[1]The citation to the recent Hanson decision should not suggest to the district court that I was influenced by the dollar amount of the claimed exemption in life insurance. I was aware of the divergence of opinion among bankruptcy judges with respect to the consideration, if any, that should be given to extensive use of unlimited exemptions. I was also aware of the restrictive amendment to the Iowa life insurance exemption which was enacted around the time I considered this case. However, to utilize the imagery of circuit Judge Arnold's concurring opinion in Hanson--this chancellor's foot is long.

weighing this evidence, the court as a finder of fact can not be oblivious to the credibility of the witnesses.

Fortunately--and perhaps amazingly, the issue of intent can be definitively determined based on the record and the demeanor of the witnesses in most cases. This was not such a case.

Rather, when I concluded that Shirley Crozier's testimony was credible I was giving her the benefit of the doubt. It appeared almost too convenient that Donald Crozier had certain records which allegedly would support her testimony but left for Florida the Saturday night before that Wednesday hearing. Although there was a suggestion that the pending dissolution was putting some strains on the contact between the Croziers in that Donald did not share the request for production of documents with Shirley, she nevertheless testified that she would be able to obtain the records when he returned. Furthermore, that they continued to be represented by the same counsel suggested that they were at least cooperating with each other to the extent necessary to prevent their attorney from finding it necessary to withdraw from the case due to a conflict of interest.

The record presented by the bank was not persuasive because I decided to take Shirley Crozier's testimony at face value. To do otherwise seemed to be punishing her for not having--due to circumstances that may have been out of her control--the records that would support her statements.

On the other hand, to overrule the objection across the board would be inequitable to the estate. If I did not allow

Donald Crozier to benefit from my difficult decision regarding Shirley Crozier's credibility and sustained the objection as to his exemption, at least his one-half interest in the life insurance policies in issue would remain in the bankruptcy estate to be administered by the trustee for the benefit of the general unsecured creditors.

Hence, with respect to the district court's specific inquiries, I was neither utilizing a default theory nor imposing sanctions for a failure to make discovery when I sustained the Bank's objection as to Donald Crozier. [2] The comments I made about Donald Crozier frustrating the discovery efforts and failing to appear at the hearing were stated preliminarily to my observation about the development of the record and were indicative of the difficulty I encountered in attempting to preserve the integrity of the bankruptcy scheme established by Congress.

In accordance with the district court's directions and pursuant to Bankruptcy Rule 8007(b), this clarification will be filed today in the bankruptcy proceeding and as soon as possible

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[2] 28 U.S.C. section 1654 allows appearance by counsel in general. Neither 11 U.S.C. section 521 nor Fed. R. Bankr. P. 4002 specifically requires a debtor to attend a hearing on an objection to exemption.

Lest the above paragraph be read too broadly, it must be remembered that 11 U.S.C. section 521(4) does require that a debtor submit any recorded information relating to property of the estate to the trustee and 11 U.S.C. section 343 mandates that a debtor appear and submit to examination at the time of the meeting of creditors.

transmitted by the bankruptcy clerk to the district court for inclusion in the record on appeal.

Signed and filed this 23rd day of June, 1989.

LEE M. JACKWIG

CHIEF U.S. BANKRUPTCY JUDGE

Place behind Decision #118 in Decision Book.

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF IOWA
CENTRAL DIVISION

IN RE: CIVIL NO. 88-1306-B
DONALD W. CROZIER and
SHIRLEY M. CROZIER, AFFIRMANCE

Debtors.

In respect to the matter appealed by Donald Crozier, I entered an order on June 8, 1989, remanding to the bankruptcy court for the limited purpose of Judge Jackwig's clarifying the basis of her ruling. She has now done that.

Based upon the record as now clarified, I conclude that the bankruptcy judge's sustaining, as to debtor Donald Crozier, the bank's objection to exemptions is not clearly erroneous, and that decision is therefore affirmed.

DATED this 26th day of July, 1989.

HAROLD D. VIETOR, Chief Judge
Southern District of Iowa

AO 450 (Rev. 5/851 Judgment in a Civil Case CD

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF IOWA - CENTRAL DIVISION

IN RE: JUDGMENT IN A CIVIL CASE

V.

DONALD W. CROZIER and
SHIRLEY M. CROZIER

CASE NUMBER: 88-1306-B

Decision by Court. This action came to consideration before the Court. The issues have been Considered and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that the bankruptcy judge's overruling of the bank's objections as to Shirley Crozier is affirmed;

IT IS FURTHER ORDERED AND ADJUDGED that the bankruptcy judge's sustaining, as to debtor Donald Crozier, the bank's objection to exemptions is not clearly erroneous and that decision is affirmed.

July 26, 1989 JAMES R. ROSENBAUM

Date Clerk