

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF: )  
)  
LYLE and CRYSTAL WORLEY, ) CASE NO. BK98-82923  
)  
DEBTORS. ) CH. 13

MEMORANDUM

Hearing was held on March 25, 1999, on a motion for turnover of funds. Appearances: Philip Kelly for the debtors and Jane Leef for Prince-Empson Agency, Inc. This memorandum contains findings of fact and conclusions of law required by Fed. Bankr. R. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(I).

Background

On August 20, 1998, creditor Prince-Empson Agency, Inc., received a default judgment in its favor against Empire Motel and Lyle Worley. The judgment arose from a breach of contract action in which Prince-Empson claimed that Lyle Worley failed to pay insurance policy premiums. The default judgment was entered in the County Court of Deuel County, Nebraska, for the amount of \$1,403.50 plus interest. On November 5, 1998, the creditor filed a garnishment with the county court in the amount of \$1431.54 against Worley. On November 13, 1998, debtors Lyle and Crystal Worley filed a Chapter 13 petition under the United States Bankruptcy Code. On November 18, 1998, the court clerk of the county court was called by an attorney associated with the debtors' attorney, who informed the court clerk that the debtors had filed bankruptcy and that the court should not pay any funds garnished from Deuel County State Bank to the creditor because the funds belonged to the bankruptcy estate. The court clerk paid the garnished amount to the creditor. The debtors now seek a turnover of the garnished funds.

Discussion

By operation of law, once a bankruptcy petition is filed the bankruptcy estate is created. The property of the bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case."

11 U.S.C. § 541(a)(1). The collective assets of the debtor, whether held by the debtor himself or held by a third party, become property of the bankruptcy estate. 11 U.S.C. § 541. Thus, funds of the debtors held either by Deuel County State Bank or the county court became property of the bankruptcy estate when the debtors filed their Chapter 13 petition on November 13, 1998.

The filing of the petition triggers the automatic stay of 11 U.S.C. § 362(a) which stays among other activities:

- (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title; . . . [and]
  
- (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title . . .

Any actions taken by a creditor to collect a debt from a debtor, which were taken after the filing of a bankruptcy petition, are void and of no legal effect. See Kalb v. Feuerstein, 308 U.S. 433, 60 S.Ct. 343 (1940); Borg-Warner Acceptance Corp. v. Hall, 685 F.2d 1306 (11th Cir.1982). Such actions are invalid even though the creditor had no notice of the bankruptcy filing. In re Miller, 10 B.R. 778 (Bankr. D. Md.1981), aff'd., 22 B.R. 479 (D. Md.1982); In re Stephen W. Grosse, P.C., 68 B.R. 847 (Bankr. E.D. Pa.1987). In addition, the creditor is not only under an affirmative duty to refuse funds, but also to reverse, suspend, or halt any garnishment already in effect upon the filing of a bankruptcy petition by the debtor. Waters v. Sherwood Municipal Court, 219 B.R. 520 (Bankr. W.D. Ark 1998); In re Dungey, 99 B.R. 814 (Bankr. S.D. Ohio 1989); In re Alberti, Neb. Bkr. 90:643 (Bankr. D. Neb. 1990).

Once the debtors in this case filed their bankruptcy petition on November 13, 1998, the creditor was stayed from utilizing the garnishment remedy and from collecting any property belonging to the bankruptcy estate. No funds held by the bank or the court should have been delivered to the judgment creditor after the petition was filed.

In a hearing conducted on March 25, 1999, the creditor argued that, pursuant to 11 U.S.C. § 542(c), the creditor should not be required to turn over funds paid over to it post petition because the officials of the county court had no actual knowledge or actual notice of the debtors' bankruptcy petition filing. The county court official's knowledge of the bankruptcy is in dispute. However, while it is true that Congress has provided a "safe harbor" for certain transfers made after the filing of the bankruptcy petition, section 542(c) does not apply to the actions of this creditor. Section 542(c) provides that:

[A]n entity that has neither actual notice nor actual knowledge of the commencement of the case concerning the debtor may transfer property of the estate, or pay a debt owing to the debtor, in good faith . . . to an entity other than the trustee, with the same effect as to the entity making such transfer or payment as if the case under this title concerning the debtor had not been commenced.

Whether or not the county court had actual knowledge of the debtors' Chapter 13 Bankruptcy is not relevant to the matter before this Court. "The protection afforded by section 542(c) applies only to the transferor or payor, and not to a transferee or payee receiving a transfer or payment, as the case may be. Such transferee or payee is treated under section 549 and section 550 of the Code." 5 Lawrence P. King, Collier on Bankruptcy § 542.04 at 542-18 (15th ed. Rev. 1999).

Prince-Empson Agency, Inc. is not a transferor under this section of the code. Prince-Empson Agency, Inc., the creditor, is a transferee and, therefore, cannot attempt to invoke this protection. If the debtors attempted to hold the county court official or the bank liable for the transfer of the debtors' funds, then those entities as transferors could invoke the protection of section 542 (c), but this "safe harbor" is not available to the transferee Prince-Empson Agency, Inc.

Although a turnover action is a proceeding to recover money or property which would ordinarily be governed by Fed. R. Bankr. P. 7001, requiring the filing of an adversary complaint, both the Fifth and Third Circuits have concluded that compliance with the requisites of an adversary proceeding may be excused by waiver of the parties. See Village Mobile Homes, Inc. v. First Gibraltar Bank (In re Village Mobile

Homes, Inc.) 947 F.2d 1282, 1283 (5th Cir. 1991) (citing In re Szostek, 93 B.R. 399 (Bankr.E.D.Pa.1988), order modified on other grounds No.89-156, 1989 WL 30648 (E.D.Pa. March 30, 1989), and 886 F.2d 1405 (3d Cir.1989) (excusing noncompliance with the adversary proceedings rules when compliance waived by parties)).

A similar approach was used in In re Rinehart, 76 B.R. 746 (Bankr. D. S.D. 1987). In Rinehart, the debtors, through the use of a motion for turnover, requested the court to require the Small Business Administration to turnover certain payments. Th Eighth Circuit Court of Appeals affirmed in Small Business Administration v. Rinehart, 887 F.2d 165 (8th Cir. 1989), without requiring that the litigation proceed as an adversary proceeding as appears to be required by Rule 7001.

In the case before this Court, neither party objected to this issue coming before the Court in the context of a motion for turnover of funds, rather than as an adversary proceeding pursuant to Rule 7001. As a result, the parties have been deemed to have waived such an objection.

Conclusion

Debtors' Motion for Turnover of Funds is granted.

Separate journal entry to be filed.

DATED: April 29, 1999

BY THE COURT:

/s/Timothy J. Mahoney  
Chief Judge

Copies faxed by the Court to:

<b>KELLY, PHILIP</b>	<b>51</b>
<b>LEEF, J.</b>	<b>308-874-3491</b>

Copies mailed by the Court to:

United States Trustee

Movant (\*) is responsible for giving notice of this journal entry to all other parties (that are not listed above) if required by rule or statute.

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DEBTOR(S). )  
)  
) CH. 13  
) Filing No.  
Plaintiff(s) )  
vs. ) JOURNAL ENTRY  
)  
)  
)  
\_\_\_\_\_  
Defendant(s) ) DATE: April 29, 1999  
HEARING DATE: March 25,  
1999

Before a United States Bankruptcy Judge for the District of  
Nebraska regarding motion for turnover of funds

APPEARANCES

Philip Kelly for the debtors  
Jane Leef for Prince-Empson Agency, Inc.

IT IS ORDERED:

Debtors' Motion for Turnover of Funds is granted. See  
Memorandum entered this date.

BY THE COURT:

/s/Timothy J. Mahoney  
Chief Judge

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**KELLY, PHILIP** 51  
**LEEF, J.** 308-874-3491

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