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## SEILLER WATERMAN BANKRUPTCY & FINANCIAL RESTRUCTURING LAW UPDATE

### PRE-BANKRUPTCY PLANNING: “WHEN A PIG BECOMES A HOG IT IS SLAUGHTERED.”

By [Charity B. Neukomm](#)



Legitimate pre-bankruptcy planning, aided by counsel, enables debtors to retain more assets. But, the line between legitimate planning and intent to defraud creditors is not clear. Not all pre-bankruptcy planning is “legitimate” in the eyes of the courts. Examples of con-  
doned conversions include:

- Conversion of a non-exempt IRA into a pension fund on the eve of bankruptcy with a net effect of an exemption of almost \$1.4 million. *Gill v. Stern* (In re Stern), 345 F.3d 1036 (9<sup>th</sup> Cir. 2003).
- Use of non-exempt savings to pay down a home mortgage and increase equity for homestead exemption. *In re Bowyer*, 932 F.2d 1100 (5<sup>th</sup> Cir. 1991).
- Use of proceeds from sale of non-exempt stock to pay down second mortgage against home and increase equity for homestead exemption. *Murphey v. Crater* (In re Crater), 286 B.R. 756 (Bankr.D.Ariz. 2002).
- Use of proceeds from sale of a motorcycle for the purchase of various exempt items (retirement fund, bankruptcy attorney, foundation donation, eye exam, groceries, and the purchase of a life insurance policy). *In re Wadley*, 263 B.R. 857 (Bankr.S.D. Ohio 2001).
- Conversion of a CD into an annuity with a life insurance company. *In Re Bronk*, \_\_\_ B.R. \_\_\_\_; 2011 WL 61605 \*17 (Bankr. W.D. Wis. January 7, 2011).

Yet, courts have cautioned that exceptions to legitimate pre-bankruptcy conversion of assets exist. “The exception is fact sensitive with a judge’s determination often hinging on whether, in the judge’s view of the debtor’s attempt to maximize exemptions, ‘a pig becomes a hog’.” *Id.*, quoting, *Albuquerque National Bank v. Zouhar* (In re Zouhar), 10 B.R. 154 at 157 (Bankr. D.N.M. 1981). “[D]ebtor’s pre-filing conduct strayed into that murky realm where overly aggressive asset protection only serves to hinder, delay, or defraud creditors, fresh starts become head starts, and pigs are safe but hogs are slaughtered.” *In Re Bronk*, \_\_\_ B.R. \_\_\_\_; 2011 WL 61605 \*1 (Bankr. W.D. Wis. January 7, 2011).

The seven factors articulated in *In Re Wadley*, 263 B.R. at 860, to determine whether the pig has, in fact, become the hog are:

1. Did the transfer occur immediately prior to the bankruptcy filing?
2. Were the converted assets a large amount or in a high value?
3. Did debtor transfer assets as a reaction to a judgment?

4. Did the debtor receive adequate consideration for the transfer?
5. Did the debtor continue to use the property transferred?
6. Was the debtor rendered insolvent by the transfer?
7. Was the conversion accompanied by concealment or conduct by debtor calculated to mislead creditors?

In *Zouhar*, the debtor’s discharge was denied when he advanced tuition for his son and obtained cash through the pledging of stock in his professional corporation in order to purchase exempt annuities. *Id.* Likewise, in *Norwest Bank Nebraska v. Tveten* (In re Tveten), 848 F.2d 871 (8<sup>th</sup> Cir. 1988), discharge was denied where, “as part of his pre-bankruptcy planning, [the debtor] liquidated almost all of his non-exempt property, converting it into exempt property worth approximately \$700,000.00.” *Id.* at 872. There, the debtor used seven-  
teen separate transfers to liquidate and convert all of his non-exempt property into life insurance and annuity contracts which could not be attached by creditors under Minnesota law. At the time of the conversion, Tveten owed \$19,000,000.00 to creditors – the debt he was seeking to discharge.

By comparison, in another case decided on the same day by the same panel of judges, a similar pre-bankruptcy plan was implicitly approved. *Hanson v. First National Bank* (In re Hanson), 848 F.2d 866 (8<sup>th</sup> Cir. 1988). On the advice of counsel, the Hansons had appraised and sold certain property which would not be exempt under South Dakota law. They sold a car, two vans, and a motor home to their son for the appraised values and their household furnishings to the husband’s brother. The amount converted totaled approximately \$35,000.00. The Hansons then used the proceeds to purchase life insurance policies and to prepay their homestead real estate mortgage. There, the court held that “the instant case falls within the myriad of cases which have permitted such a conversion.”

The end result is that pre-bankruptcy planning aided by the advice of counsel will enable debtors to retain more assets and avoid potential litigation.

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For more information on this topic or any other legal concerns or questions, please contact your Seiller Waterman attorney.

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