In the United States Bankruptcy Court

for the Northern District of Iowa

Western Division

CARGO, INC. Debtor.	Bankruptcy No. X90-00200S Chapter 7
WIL FORKER, Trustee Plaintiff vs. PLM INTERNATIONAL, INC. Defendant.	Adversary No. X91-0019S

ORDER RE: PLM's MOTION FOR SUMMARY JUDGMENT

In this proceeding, trustee seeks to recover from PLM International, Inc. an allegedly preferential payment in the amount of $76,700.00. PLM International, Inc. (PLM) has moved for summary judgment. Hearing on the motion was held on July 16, 1991 in Sioux City.

FINDINGS OF FACT[(1)]

The debtor, Cargo, Inc., by written agreement, leased 50 refrigerated truck trailers to Cargo, Inc. (CARGO) for a 24-month period. Although it does not appear in the affidavits submitted to the court, the lease, at or after its expiration, was apparently extended to include the months of December, 1989 and January, 1990. The lease payment for the two months was to be $76,700.00. When payment of this amount became delinquent, PLM hired James Kozak or his employer, D & R Recovery, Inc., to repossess the trailers from Cargo. Kozak went to a Cargo business location on December 9, 1989 to repossess the trailers. Kozak told Cargo officials that he was doing business as D & R Recovery, Inc., that he was acting on behalf of PLM International, Inc., and that the only way to stop his repossession of the trailers was to pay PLM $76,700.00.

At the time Frank Dejute was the only Cargo officer authorized to sign checks on behalf of Cargo. Since he was not present, an official of Tauro Brothers Trucking Co. (TAURO), the parent company of Cargo, executed and delivered its check to Kozak to prevent repossession. At Kozak's request, the check, in the amount of $76,700.00, was made payable to PLM Financial Services, Inc. The latter is a wholly owned subsidiary of PLM.

Kozak converted the payment to his own use.

On December 11, 1989, Cargo paid Tauro $76,000.00 to reimburse it for Tauro's payment to PLM. (Forker affidavit, paragraph 4.) Payment was by two checks, one of which was returned for insufficient funds. On December 21, 1989, Cargo paid Tauro $38,700.00, and as of that date, Tauro was fully reimbursed. By proof filed with the court, Tauro Brothers claims to have a blanket security interest in Cargo's accounts receivable and inventory. The trustee's affidavit states that these assets were the only ones of substantial value which the debtor owned. Cargo filed bankruptcy on February 6, 1990.

DISCUSSION

PLM moves for summary judgment on the trustee's complaint on three grounds: (1) that under the "earmarking doctrine" the property purportedly transferred to PLM was not property of the debtor; (2) that payment was made by Tauro, not to the defendant but to its subsidiary and thus PLM is not a proper defendant; and (3) that PLM never received the money because of the embezzlement by its agent.

Earmarking

In order to be considered preferential, the transfer under consideration must be a transfer "of an interest of the debtor in property. . . . " 11 U.S.C. 547(b) When the funds to pay off an old creditor are provided by a new creditor, the funds are outside of the control of the debtor, and the transaction, when viewed as a whole, does not diminish the debtor's estate, the funds are said to be "earmarked" and the transfer is not considered to be preferential because it does not involve a transfer of the debtor's property. The Eighth Circuit Court of Appeals has described the earmarking doctrine as follows:

> When new funds are provided by the new creditor to or for the benefit of the debtor for the purpose of paying the obligation owed to the old creditor, the funds are said to be "earmarked" (footnote omitted) and the payment is held not to be a voidable preference.

McCuskey v. The National Bank of Waterloo (In re Bohlen Enterprises, Ltd.), 859 F.2d 561, 565 (8th Cir. 1988).

The earliest applications of the doctrine involve payment to the old creditor by guarantors or other third parties who were obligated with the debtor to the old creditor. Id. at 565. In Bohlen, the Circuit Court called into question, but did not decide, whether the doctrine should have been extended, as it has, to cover advances by new lenders. Id. at 566. It did not decide the issue because it concluded that even if advances by new lenders should be covered by the earmarking doctrine, the advance in question in Bohlen did not satisfy all of the necessary requirements for application of the earmarking doctrine. Three necessary requirements are:

> 1. the existence of an agreement (footnote omitted) between the new lender and the debtor that the new funds will be used to pay a specified antecedent debt,
> 2. performance of that agreement according to its terms, and
> 3. the transaction viewed as a whole (including the transfer in of the new funds and the transfer out to the old creditor) does not result in any diminution of the estate.

Id. at 566.

A diminution to the estate can result from a grant by the debtor of a security interest to the new lender. In re Muncrief, 900 F.2d 1220, 1224 (n. 4) (8th Cir. 1990); Brown v. First National Bank of Little Rock, Arkansas, 748 F.2d 490, 491 (8th Cir. 1984).

The trustee's affidavit indicates that Tauro had a security interest in valuable assets of the estate. It may be that Tauro's advance to PLM on behalf of Cargo caused a security interest in favor of Tauro to attach to Cargo's property. The trustee's affidavit creates a fact issue which, if resolved in favor of the trustee, could prevent the application of the earmarking doctrine. Before the court can determine the applicability of the earmarking doctrine, it must consider whether, as a result of Tauro's advance, a security interest in Cargo property attached. The court must also consider the value of such an interest. An inquiry into value raises other fact issues: Was Tauro already a secured creditor of Cargo?--What was the amount of existing debt, if any?--What was the value of the collateral? --Were there any prior security interests?--If a security interest in favor of Tauro attached to Cargo's accounts receivable and inventory at the time of the advance, was Cargo's debt to Tauro fully or partially secured? The value of the security interest at the time of the attachment is relevant because the transfer from Tauro to PLM may only be preferential to the extent that unencumbered assets were encumbered by the attachment of the security interest. Mandross v. Peoples Banking Co. (In re Hartley), 825 F.2d 1067 (6th Cir. 1987).

Although the quality of the trustee's resistance would be insufficient at trial to support his position that a security interest attached, for the purpose of the motion for summary judgment, the court finds that genuine issues of material fact are in dispute. PLM may not obtain judgment as a matter of law.

Other Issues

PLM argues that it is not the proper defendant in this case because the payment in question was made to PLM Financial Services, Inc. The only evidence bearing on this issue is that Kozak requested that the check for the lease obligation be made payable to PLM Financial Services, Inc. This was a wholly-owned subsidiary of PLM. Based on the evidence, the court concludes that the payment by Tauro was made to PLM Financial Services, Inc. for the benefit of PLM. The benefit to PLM is all that is necessary to make it a proper party to the preference action. 11 U.S.C. S 547(b)(1).

Embezzlement of the Payment

By affidavit, PLM has shown that the payment by Tauro was never received by PLM. Rather, it was embezzled by Kozak, PLM's apparent agent. Although the evidence of the agent's authority is somewhat meager, it appears that Kozak, or his company, had actual or apparent authority to collect the lease payment as an alternative to the repossession of the vehicles. Even if Kozak embezzled the payment, such a wrong would normally not alter the legal effect of the payment. Generally, embezzlement by a collecting agent does not prevent the payor from raising the defense of payment if the creditor again attempts to collect.

McCullough V. Reynolds, 8 Iowa 1089, 165 N.W. 333, 336 (1917). PLM does not dispute Kozak's right to collect the debt. His embezzlement of the payment does not prevent the preference suit by the trustee.

CONCLUSION

The court finds there are genuine issues of material fact in dispute regarding the issue of earmarking. Based on the evidence before the court and because there are disputed factual issues, the court concludes that PLM is not entitled to judgment.

ORDER

IT IS ORDERED that the motion of PLM International, Inc. for summary judgment is denied.

SO ORDERED ON THIS 13th DAY OF AUGUST, 1991.

William L. Edmonds
Bankruptcy Judge

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1. These findings are based solely on the affidavits submitted to the court. Although the briefs suggest other facts related to the dispute, these other facts are not supported by affidavit or testimony.