Appeal History:

Reversed by 227 B. R. 153 (B. A. P. 8th Circuit 1998)

In the United States Bankruptcy Court

for the Northern District of Iowa

Western Division

DAVID G. CALVERT and
SANDRA M. CALVERT
Debtor(s).

Bankruptcy No. 97-00556S

Chapter 7

WILL L. FORKER Trustee
Plaintiff(s)

vs.

DUENOW MANAGEMENT CORPORATION
Defendant(s)

Adversary No. 97-9126S

TRUSTEE SEEKS TO AVOID AS A PREFERENCE A TRANSFER

Trustee Wil L. Forker seeks to avoid as a preference a transfer to Duenow Management Corp. Trial was held April 23, 1998 in Sioux City. Wil L. Forker appeared on his own behalf. Jeffrey L. Poulson appeared for Duenow Management Corp. (Duenow). This is a core proceeding under 28 U.S.C. § 157(b)(2)(F).

David G. Calvert (Calvert) and his wife Sandra filed a joint chapter 7 petition on March 5, 1997. Calvert had been manager of a Kentucky Fried Chicken outlet located in Sioux City. It was owned by Duenow. He lost his job in November 1996 because Duenow believed he had embezzled from it. Calvert settled Duenow's claim against him in December 1996. He paid Duenow $11,844.90.

He had borrowed the money from his parents, Glen and Marylou Calvert. He agreed with his parents that the loan would be used to pay Duenow's claim. Calvert's mother brought $12,000.00 in cash to her son on December 18, 1996. On the same day, Calvert and his wife took the money to the bank, and he purchased a cashier's check payable to Golby Uhlir, his attorney (Exhibit 1). Uhlir had negotiated the settlement with Duenow. On December 18, Uhlir purchased a cashier's check for $11,844.90 payable to Duenow Corporation[(1)] and Gene C. Duenow (Exhibit 2) and sent it to them with his cover letter (Exhibit 3).

Also on December 18, David and Sandra Calvert executed a "Mortgage Note" to his parents promising to repay $11,884.90.[(2)] Debtors gave Calvert's parents a mortgage on their home (Exhibit 6). They also say they gave his parents a lien on their 1992 Ford Ranger pickup truck. No security agreement was offered into evidence, but a copy of the Certificate of Title was admitted showing the notation of a lien in favor of Glen M. Calbert (sic) (Exhibit 5).

At the time they gave the mortgage, the debtors' home had a value of $52,755.00. There was a first mortgage against it

which on December 1, 1996 had a balance of $48,782.52, and a second mortgage with a balance of $2,969.10. Also at the time of the mortgage, there were real estate taxes due in the amount of $1,230.84. The debtors had a mortgage escrow account with the first mortgagee. On December 18, the account had a balance of $399.16. This money was to be used for taxes as well as insurance. As of December 1, 1996, the debtors had an equity in their home of $17.17. I estimate this as less than two days of interest on the loan (see Exhibit 7, Escrow Statement). As the mortgage to Calvert's parents was given on December 18, 1996, I find that at the time the mortgage was given, there was no value to the home as collateral. On December 18, the pickup had a value of $8,875.00. It was not encumbered.

Debtors were insolvent at the time of the payment to Duenow. The payment enabled Duenow to receive more than it would have received on its claim under and in accordance with chapter 7 if the payment had not been made.

Section 547(b) of the Bankruptcy Code (Title 11, U.S. Code) provides that

> [T]he trustee may avoid any transfer of an interest of the debtor in property--
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;
>
> (4) made--
>
> (A) on or within 90 days before the date of the filing of the petition ... and
> (5) that enables such creditor to receive more than such creditor would receive if--
> (A) the case were a case under chapter 7 of this title;
>
> (B) the transfer had not been made; and
>
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b)(1)-(5).

The only dispute between the parties is whether the transfer was the transfer of an interest of the debtor in property. The defendant contends that the loaned funds were earmarked for Duenow

and, therefore, were not property of the debtors. The trustee contends that the earmarking doctrine does not apply because the debtors gave security for the loan.

The "earmarking" doctrine is a "judicially created defense to preference actions." Buckley v. Jeld-Wen, Inc. (In re Interior Wood Products Co.), 986 F.2d 228, 231 (8th Cir. 1993). It is "entirely a court-made interpretation of the statutory requirement that a voidable preference must involve a 'transfer of an interest of the debtor in property.'" McCuskey v. National Bank of Waterloo (In re Bohlen Enterprises, Ltd.), 859 F.2d 561, 565 (8th Cir. 1988).

To satisfy the doctrine, the transaction must meet these requirements:

> (1) There must be an agreement between the debtor and the new lender that the new funds will be used to pay a specified antecedent debt.
>
> (2) The agreement must be performed according to its terms.
>
> (3) The transaction viewed in its entirety cannot result in any diminution of the debtor's estate.

see id. at 566.

Under the doctrine, it is explained that no avoidable transfer is made because the loaned funds never become part of the debtor's property. Interior Wood Products, 986 F.2d at 231. There is no preference if the new creditor is merely substituted for the old creditor. Id. But the doctrine applies only if the new and old creditor enjoy the same priority. Kaler v. Community First National Bank (In re Heitkamp), 137 F.3d 1087, 1089 (8th Cir. 1998).

> Thus, the doctrine applies when a security interest is given for funds used to pay secured debts, but not when a security interest is given for funds used to pay an unsecured debt.

Id.; see Brown v. Mt. Prospect State Bank (In re Muncrief), 900 F.2d 1220, 1224 & n.4 (8th Cir. 1990). This is the "security interest" exception to the doctrine. Brown v. Mt. Prospect State Bank (In re Muncrief), 900 F.2d 1220, 1224 n.4 (8th Cir. 1990). If the exception applies, the transfer is not earmarked, and is therefore avoidable, to the extent the transfer depleted the debtor's estate, "that is to the extent of the value of the collateral given up by the estate to secure the loan." Mandross v. Peoples Banking Co. (In re Hartley), 825 F.2d 1067, 1071 (6th Cir. 1987).

The burden of proof is on the trustee to prove that the earmarking doctrine does not apply. Kaler v. Community First National Bank, 137 F.3d at 1089. The trustee contends that the exception is met because of the security interests given Calvert's parents to secure the loan used to pay Duenow.

Duenow, on the other hand, argues that the trustee has failed to prove that the debtors' estate was diminished by any transfer to the parents. Duenow argues first that there was no equity in the property covered by the real estate mortgage and, second that the trustee has not proven that an enforceable security agreement was transferred in the pickup.

I agree with defendant's contention as to the real estate mortgage but not as to the motor vehicle lien. The factual findings show that at the time debtors gave the mortgage to Calvert's parents, there was no equity in the home. The transfer to Duenow is avoidable only to the extent the debtors financed it with a security interest having value. It did not. The granting of security interest in the home to Calvert's parents did not result in a voidable transfer to Duenow.

In order to prove that a transfer of an interest in the pickup truck resulted in an avoidable transfer to Duenow, the trustee must show the transfer of an interest enforceable against the estate. In order for a security interest to attach to goods, such as a vehicle, and to be enforceable against a third party, the debtor must have "signed a security agreement which contains a description of the collateral" or the collateral must be in the possession of the secured party. Neb. Rev. St. U.C.C. §

9-203(1)(a) (1997).

Calvert's parents were not in possession of the truck, and no written security agreement has been offered into evidence. Calvert testified that he gave the title to the truck to his parents. His schedules show he believes that his parents had a security interest in the truck (Exhibit 7, schedule D).

The trustee has proven perfection. In Nebraska, where title to the truck was issued, perfection of a security agreement in the nature of the one alleged is accomplished by notation of the lien on the certificate of title. Neb. Rev. St. § 60-110. The title to the pickup does note "Glen M. Calbert" as a lienholder (Exhibit 5). The Certificate of Title was not signed by either debtor.

The issue squarely presents itself as to whether the court may presume a valid written security agreement signed by Calvert from the notation of the lien on the title. Section 60-110 of the Nebraska Revised Statutes states in pertinent part:

> The holder of a security agreement, trust receipt, conditional sales contract, or similar instrument, upon presentation of such instrument to the county clerk of the county where such certificate of title was issued or, if issued by the department, to the department together with the certificate of title and the fee prescribed by section 60-115, may have a notation of such lien made on the face of such certificate of title. The county clerk or the department shall enter the notation and the date thereof over the signature of such officer or

> deputy and the seal of office and shall also note such lien and the date thereof on the duplicate of same on file. If noted by a county clerk, he or she shall on that day notify the department which shall note the lien on its records. The county clerk or the department shall also indicate by appropriate notation and on such instrument itself the fact that such lien has been noted on the certificate of title.

Nebraska Rev. St. § 60-110.

> The title shows the date of notation of the father's lien, the signature and seal of the County Clerk (Exhibit 5).
>
> The Nebraska Supreme Court has stated:
>
> [T]he law presumes official acts of public officers in a collateral attack thereon to have been done rightly, and with authority, and that in such a collateral attack acts done which presuppose the existence of other acts to make them legally operative are presumptive proof of [the existence of such other acts].

Majerus v. School District No. 52 of Richardson County, 139 Neb. 823, 299 N.W. 178, 179 (1941), *accord* Hamilton County v. Thomsen, 158 Neb. 254, 63 N.W.2d 168, 173-74 (1954).

The contention that there is no underlying security agreement appears to be a collateral attack on the action of the county clerk in noting the lien on the title. A dispute between the trustee and Calvert's parents over the enforceability of the lien would be a direct attack, so would be an action by the trustee or the debtor against the county to have the notation removed. This proceeding by the trustee is against a stranger to the title and the lien. I conclude that the trustee is entitled to the presumption because his claim against Duenow does not directly involve a dispute between the trustee and Calvert's parents or the county.

Duenow argues that the presumption is adequately rebutted by deposition testimony of Golby Uhlir, Calvert's attorney. Uhlir represented the debtors. He prepared the note and mortgage, but he did not prepare a security agreement on the truck. That Uhlir did not prepare such an agreement is not sufficient to rebut the presumption that one was prepared and presented to the county clerk. In other words, that Uhlir did not prepare a security agreement on the truck is not sufficient evidence to find that no security agreement was prepared.

Second, Duenow argues that a fair reading of § 60-110 precludes use of the presumption. The statute permits the holder of a "security agreement, trust receipt, conditional sales contract, or similar instrument" to have the lien noted on the title on presentation of the instrument to the clerk. Duenow says that the term "similar instrument" could permit the lien to be noted by presentation of a document less exacting in its requirements than a "security agreement." For example, the lien might be noted by filling out a mere application. Duenow contends that because such an application may not serve the function of a security agreement, the presumption goes too far in its application to § 60-110.

The Nebraska statutes use the term "security agreement" in

U.C.C. §§ 9-105(1), 9-203(1)(a) and in § 60-110. Section 9-105(1) defines a "security agreement" as "an agreement which creates or provides for a security interest." Attachment and enforceability of a security interest requires that the agreement be signed by the debtor and that it contain a description of the collateral. I presume that the legislature intended the same meanings for "security agreement" when it used the terms in § 60-110 and in U.C.C. § 9-203(1)(a). See Farmers Co-op Co. v. DeCoster, 528 N.W.2d 536, 538 (Iowa 1995)(presuming legislature enacts consistent provisions, especially when using same term in statutes with similar purpose).

I conclude that the use of the term "similar instrument" in § 60-110 is not intended to permit notation of the lien based on documents or instruments less probative than a security agreement of the applicant's right to notation of the lien. The term "instrument" denotes a writing. To permit the clerk to carry out the notation, it would have described the truck. It is defined to require execution. Burton's Legal Thesaurus defines "instrument" as

> bill, certificate, charter, deed, draft, evidential writing, executed and delivered writing, formal writing, official record, official writing, paper, record, solemn writing, ..., writing, writing delivered as the evidence

of an agreement, writing which gives formal expression to a legal act, written formal expression.

Burton, William C., Legal Thesaurus, p. 289 (1980).

An instrument which did not provide for or grant a security interest would not be similar to a security agreement.

The trustee is entitled to a presumption that the Dakota County Clerk noted Glen M. Calvert's lien on the title to the truck because, as prescribed in the Nebraska statute, he was provided with a signed security agreement on the truck from the owner to Glen Calvert. The presumption has not been rebutted. I find, therefore, that the debtor or debtors as co-owner(s) signed a security agreement granting Glen M. Calvert a security interest in the truck and that the agreement attached and was enforceable. Defendant has made no other argument that the lien is not enforceable against the trustee. I find and conclude that to the extent of the value of the pickup truck--$8,875.00--the transfer to Duenow was an avoidable preference and may be avoided.

IT IS ORDERED that the transfer of $8,875.00 to Duenow Management Corp. is avoided and that the plaintiff, Wil L. Forker, trustee, shall recover from Duenow Management Corp. the sum of $8,875.00 plus the costs of this action. Judgment shall enter accordingly.

SO ORDERED THIS DAY OF APRIL 1998.

William L. Edmonds
Chief Bankruptcy Judge

I certify that on I mailed a copy of this order and a judgment by U.S. mail to Wil Forker, Jeffrey Poulson, and U.S. Trustee.

1. The parties have not said that there is legal or factual significance to the variation in names between defendant Duenow Management Corp. and the payee on Uhlir's check which was Duenow Corporation of Nebraska, Inc.

2. There was no explanation for the difference between the amount loaned, the amount of the Mortgage Note and the amount of the check payable to Duenow.