

1 **WRITTEN DECISION - FOR PUBLICATION**

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ENTERED **SEP 26 2013**
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CLERK, U.S. BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA
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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA

11 In re) Case No. 09-09536-PB7
12) Adv. No. 11-90280-PB
13 PAUL EUGENE VASSAU and)
14 JULIE ANN VASSAU)
15 Debtors.) ORDER ON TRUSTEE'S
16) MOTION FOR SUMMARY
17) JUDGMENT
18)
19 LESLIE T. GLADSTONE, Chapter 7)
20 Trustee,)
21)
22 Plaintiff,)
23)
24 v.)
25)
26 BANK OF AMERICA, N.A.,)
Defendant.)

21 The facts of this case are neither uncommon nor disputed.
22 When this case was filed, and during the ninety days before,
23 Debtors' residence was subject to two deeds of trust securing
24 obligations to two creditors - the Senior Lienholder and Junior
25 Lienholder. The property was worth more than the claim of the
26 Senior Lienholder, but less than the claims of Senior Lienholder

1 and Junior Lienholder combined. In other words, the Senior
2 Lienholder was fully secured and the Junior Lienholder was
3 partially secured.

4 Debtors fell behind on their payments to Senior Lienholder.
5 Within the 90 days prior to the petition, the Debtors made ten
6 payments to the Senior Lienholder.

7 Though the transfers were made to the Senior Lienholder,
8 Trustee seeks to avoid the transfers on the theory that they were
9 preferences as to the Junior Lienholder. The Trustee and the
10 Junior Lienholder have both moved for summary judgment. This
11 Order addresses the Trustee's motion.

12 13 **BACKGROUND**

14 Paul Eugene Vassau and Julie Ann Vassau (Debtors) filed
15 their petition on July 1, 2009. Leslie Gladstone was appointed
16 chapter 7 trustee (Trustee). Debtors scheduled the real property
17 located at 7071 Rose Drive, Carlsbad, California 92001 (the
18 "Property"). As of the petition date, the Property was worth
19 approximately \$1.1 million dollars.¹

20 At all times relevant to this matter, the Property was
21 subject to a first priority lien in favor of Bank of America (as
22 successor in interest of Countrywide Bank) ("Senior Lienholder")

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25 ¹ The Trustee contends the value of the Property is \$1,156,000. Junior Lienholder has it at
26 \$1,063,900. For the purpose of this preference action, it is of no import which is correct. The only
thing that matters is that there is sufficient value to fully secure the claim of Senior Lienholder, but
only partially secure Junior Lienholder.

1 under Loan No. -3720, and a second priority lien in favor of Bank
2 of America (as successor in interest of Countrywide Bank)
3 ("Junior Lienholder") under Loan No. 3728.² Prior to the
4 payments discussed below, the amount owed to the Senior
5 Lienholder was approximately \$987,920.00, and the amount owed to
6 Junior Lienholder was approximately \$264,717.21. Given the \$1.1
7 million value of the Property, the claim of the Senior Lienholder
8 was fully secured, while the claim of the Junior Lienholder was
9 only partially secured.

10 During the 90 days before the date the petition was filed,
11 the Debtors made ten payments to the Senior Lienholder totalling
12 \$41,716.45 (the "Transfers"). The Transfers were applied to
13 interest charges, late charges, the negative escrow balance and
14 miscellaneous charges, all of which would be secured under the
15 senior deed of trust. Had the Transfers not been made, the fully
16 secured claim of the Senior Lienholder would have been greater by
17 \$41,716.45.

18 DISCUSSION

19 The Transfers were all made to the Senior Lienholder - no
20 transfers were made to the Junior Lienholder. Nevertheless, the
21 Trustee seeks to avoid the Transfers on the theory that they were
22 preferential transfers as to the Junior Lienholder. As the
23 Trustee explains:

24 _____
25 ² While BofA holds the senior lien and the junior, BofA is the Defendant in this action only
26 as the Junior Lienholder.

1 Defendant Junior Lienholder benefitted from the
2 Transfers because the effect of the Transfers was to
3 reduce the amount of the Senior Lienholder's secured
4 claim on the Real Property and correspondingly increase
5 the value of Defendant's security interest in the Real
6 Property.

7 That is, had the Transfers not been made the amount of the fully
8 secured claim of the Senior Lienholder would be \$41,716.45
9 greater. That \$41,716.45 would reduce the amount by which the
10 claim of Junior Lienholder was secured dollar for dollar. The
11 Transfers reduced Senior Lienholder's secured claim and
12 correspondingly increased that of Junior Lienholder dollar for
13 dollar.³

14 In order to avoid a transfer as a preference, a trustee must
15 establish each of the requirements of Bankruptcy Code § 547(b),
16 which provides:

17 (b) Except as provided in subsections (c) and (I) of
18 this section, the trustee may avoid any transfer of an
19 interest of the debtor in property--

20 (1) to or for the benefit of a creditor;

21 (2) for or on account of an antecedent debt owed by the
22 debtor before such transfer was made;

23 (3) made while the debtor was insolvent;

24 (4) made--

25 (A) on or within 90 days before the date of the filing
26 of the petition; or

(B) between ninety days and one year before the date of
the filing of the petition, if such creditor at the
time of such transfer was an insider; 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

³ Put another way, but for the Transfers, Junior Lienholder would have a secured claim of X and an unsecured claim of Y. Due to the Transfers, Junior Lienholder has a secured claim of X plus \$41,716.45 and an unsecured claim of Y minus \$41,716.45.

1 (C) such creditor received payment of such debt to the
2 extent provided by the provisions of this title.

3 The Junior Lienholder concedes that a transfer of an
4 interest of the Debtors in property was made and that elements
5 (b) (2), (3) and (4) are established. The Junior Lienholder
6 contests elements (b) (1) and (5). Junior Lienholder also asserts
7 § 547(i) as a sort of defense.

8 **Section 547(i)**

9 Junior Lienholder's first argument is based upon a
10 misunderstanding of § 547(i). That subsection provides:

11 (i) If the trustee avoids under subsection (b) a
12 transfer made between 90 days and 1 year before the
13 date of the filing of the petition, by the debtor to an
14 entity that is not an insider for the benefit of a
15 creditor that is an insider, such transfer shall be
16 considered to be avoided under this section only with
17 respect to the creditor that is an insider.

18 The Trustee's theory in this case, and that contemplated under §
19 547(i) are similar in that they both deal with a situation in
20 which a transfer is preferential to one party, but not another.
21 That, though, is where the similarity ends. Citing § 547(i),
22 Junior Lienholder argues "Non-insiders who indirectly benefit
23 from a payment by the debtor are not liable for a preference."
24 That is not what § 547(i) says.

25 First, the Transfers the Trustee seeks to avoid were not
26 made "between 90 days and 1 year" before the petition, they were
made within 90 days. Second, neither Senior Lienholder nor
Junior Lienholder are insiders.

Subsection 547(i) applies to the situation where an transfer

1 is made to a non-insider, but indirectly benefits an insider.
2 The transfer may be a preference as to the insider, to whom the
3 one-year look back period applies, but not the non-insider, who
4 is protected by the 90-day look back period. That is not the
5 situation we have in this case. Section 547(i) simply does not
6 apply to the facts of our case.

7 **(b)(1) to or for the benefit of a creditor;**

8 Junior Lienholder concedes, as it must, that as of the date
9 of the Transfers, it was a creditor of the Debtors. It denies,
10 however, that the Transfers were made for its benefit. It is not
11 entirely clear, but it appears Junior Lienholder's argument is
12 that the Transfers do not satisfy § 547(b)(5), because the
13 Debtors did not intend that the Transfers benefit it. This
14 misunderstanding is understandable. In the absence of case law
15 to the contrary, the word "for" in the phrase "for the benefit of
16 a creditor," could be read to require the debtor make the
17 transfer with the intent of benefitting the creditor. However,
18 there is in fact ample case law to the contrary. Indeed, it is
19 well established that the intent of the parties is irrelevant to
20 the preference analysis.

21 Professor Vern Countryman explained in his comprehensive
22 article, "The Concept of a Voidable Preference in Bankruptcy,"
23 that intent on the part of the debtor has not been an element of
24 preference since 1910, and intent on the part of the transferee
25 or beneficiary was removed as of 1978. 38 Vand.L.Rev. 713, 722-

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1 23; 726 (1985).

2 The court in In re Phelps Technologies, Inc., elaborated:

3 what the parties might have intended is immaterial.
4 Because a preference "is an infraction of the rule of
5 equal distribution among all creditors," ...neither the
6 intent nor motive of the parties is relevant in
7 consideration of an alleged preference under § 547(b)."
8 Matter of Criswell, 102 F.3d 1411, 1414 (5th Cir.
9 1997) (quoting 4 Collier On Bankruptcy ¶ 547.01, at
10 547-12, 13 (15th ed.1996)). "[I]t is the effect of the
11 transaction, rather than the debtor's or creditor's
12 intent, that is controlling." 5 Collier On Bankruptcy ¶
13 547.01, at 547-14, 15 (15th ed.1999) (emphasis in
14 original). See also, Corporate Food Management, Inc. v.
15 Suffolk Community College (In re Corporate Food
16 Management, Inc.), 223 B.R. 635, 641
17 (Bankr.E.D.N.Y.1998). Therefore, what the parties might
18 have intended to accomplish in this instance is
19 immaterial; the effect of what was done is controlling.

20 245 B.R. 858, 867 (Bankr.W.D.Mo. 2000).

21 Thus, § 547(b)(1) cannot be read to require an intent to
22 benefit. Rather, "for the benefit of a creditor," merely
23 requires that the transfer actually benefitted the creditor. In
24 the case at hand it is clear the Junior Lienholder benefitted
25 from the Transfers. The effect of the Transfers was to increase
26 the equity in the Property available to secure the claim of
Junior Lienholder. Due to the Transfers, Junior Lienholder has a
larger secured claim, and a correspondingly smaller unsecured
claim in this bankruptcy case. The impact of the Transfers is
the same as if Debtors had pledged new collateral worth
\$41,716.45.

On facts very similar to the ones at hand the Seventh
Circuit held that transfers to a senior lienholder benefitted the

1 junior lienholder:

2 Gateway as junior lienholder benefitted from the
3 improvement in Marine's position. The bankruptcy court
4 found that as Marine's debt secured by the East
5 Washington store inventory decreased, Gateway's
6 security was thereby increased dollar for dollar. This,
7 the court determined, resulted in an indirect
8 preferential transfer to Gateway to the extent the
9 amount transferred to Marine reduced the fund for
10 payment to other creditors with unsecured claims. The
11 court found Gateway to have been indirectly preferred
12 in the amount of \$59,643.71-the amount by which
13 Marine's security exceeded its claim.

14 In the Matter of Prescott, 805 F.2d 719, 723 (7th Cir. 1986).

15 The Court finds that the Transfers benefitted Junior
16 Lienholder, and that § 547(b) (1) has been satisfied.

17 **(b) (5) "that enables such creditor to receive more than such
18 creditor would receive if the case were a case under chapter 7**

19 The Court has struggled with how this element is to be
20 applied. Though the term "liquidation" is not included in the
21 statute, this is often referred to as the hypothetical
22 liquidation test, and appears to be applied by conducting a
23 hypothetical liquidation, in which the hypothetical trustee sells
24 all of the non-exempt assets of the estate, and distributes the
25 proceeds according to the priority scheme under the Code. Many
26 courts applying this element use the term "liquidation" for "a
case under chapter 7 of this title." For example, the Tenth
Circuit set out the elements of preference as follows:

Bankruptcy Code § 547(b), 11 U.S.C. § 547(b), provides
that a trustee may avoid the transfer of a debtor's
interest in property: (1) to a creditor; (2) for an
antecedent debt; (3) made while the debtor was

1 insolvent; (4) within ninety days of the filing of a
2 petition for relief in bankruptcy; (5) that enables the
3 creditor to receive more than the creditor would
4 receive if the transfer had not been made and the
debtor's estate were *liquidated* under Chapter 7 of the
Bankruptcy Code.

5 Porter v. Yukon National Bank, 866 F.2d 355, 356 (10th Cir.
6 1989) (emphasis added). See also, In re Johnson Memorial Hosp.,
7 Inc., 470 B.R. 119, 123 (Bankr.D.Conn. 2012) ("hypothetical
8 Chapter 7 liquidation..."); In re Frankum, 453 B.R. 352, 367
9 (Bankr.E.D.Ark. 2011) ("....the 'hypothetical Chapter 7 test.'
10 This test provides that a preference exists only if the
11 transferred property enables the creditor to receive more than it
12 otherwise would under a Chapter 7 liquidation of the debtor's
13 estate."); In re Property Leasing & Management, 46 B.R. 903, 911
14 (Bankr.E.D.Tenn. 1985) ("the determinative inquiry regards the
15 final element of a preferential transfer under § 547(b) - i.e.,
16 whether [undersecured creditor] received more as a result of the
17 Payments than it would otherwise have received under a chapter 7
18 liquidation...")

19 This approach appears to be the one taken by the court in
20 Prescott, discussed above. In that case the court held that the
21 trustee met his burden under § 547(b)(5) simply by establishing
22 that the transferee was undersecured. 805 F.2d at 726.

23 The potential problem with these cases is that the language
24 of the Code does not say "liquidation." Rather, it provides "(5)
25 that enables such creditor to receive more than such creditor
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1 would receive if--(A) the case were a case under chapter 7 of
2 this title; (B) the transfer had not been made; and (C) such
3 creditor received payment of such debt to the extent provided by
4 the provisions of this title." Admittedly, chapter 7 is entitled
5 "Liquidation." However, in practice it is a rare case in which a
6 debtor's assets are actually sold and proceeds paid to creditors.
7 In jumping to a hypothetical liquidation, the courts potentially
8 ignore one of the realities of chapter 7 practice. That is, that
9 chapter 7 trustees rarely liquidate over-encumbered assets.
10 Rather, they are abandoned.

11 Section 704(a)(1) instructs the trustee to "collect and
12 reduce to money the property of the estate..." However, § 554(a)
13 authorizes a trustee to "abandon any property of the estate that
14 is burdensome to the estate...." A chapter 7 trustee generally
15 will not administer an asset unless it will produce a net return
16 for the estate. When an asset is fully encumbered by a lien, it
17 is considered improper for a chapter 7 trustee to liquidate the
18 asset. See e.g., In re Preston Lumber Corp., 199 B.R. 415
19 (Bankr.N.D.Cal.1996). Instead, a trustee would abandon the
20 property.

21 Thus, it seems to the Court that there are at least two
22 approaches possible under § 547(b)(5), each leading to different
23 results in this case. If the hypothetical chapter 7 case element
24 requires a simple hypothetical liquidation, then the Trustee has
25 carried her burden. The Trustee has declared that the assets of
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1 the estate are insufficient to pay all unsecured claims in full.
2 Junior Lienholder has not disputed this fact. If the assets were
3 to be sold and distributed as directed, the Property would be
4 sold. The Senior Lienholder would be paid the outstanding
5 balance on its secured claim. To the extent proceeds remained,
6 they would be paid over to Junior Lienholder. Then, to the
7 extent Junior Lienholder's claim was not satisfied, Junior
8 Lienholder would have an unsecured claim, which would share pro
9 rata with the other unsecured creditors, which, according to the
10 Trustee's undisputed evidence, would be less than 100%. Had the
11 Transfers not been made, the secured claim of Senior Lienholder
12 would be larger by the amount of the Transfers, and less would be
13 available to Junior Lienholder on its secured claim, and the
14 amount of the unsecured claim, which is paid less than 100%,
15 would be greater. Hence, the Transfers would result in Junior
16 Lienholder receiving more in the chapter 7 case than they would
17 had the Transfers not been made and the (b) (5) element will have
18 been satisfied.

19 If, on the other hand, the Court assumes the hypothetical
20 chapter 7 trustee would act as a typical chapter 7 trustee, the
21 result is quite different. As noted, a typical trustee would
22 abandon an overencumbered property. That, in fact, is what the
23 Trustee did in this case. So, the question becomes, what would
24 Junior Lienholder "receive" in the hypothetical chapter 7 case?

25 Abandoned property ceases to be part of bankruptcy estate
26

1 and reverts to debtor and stands as if no bankruptcy petition
2 were filed. In re Dewsnup, C.A.10 (Utah) 1990, 908 F.2d 588,
3 certiorari granted 111 S.Ct. 949, 498 U.S. 1081, 112 L.Ed.2d
4 1038, affirmed 112 S.Ct. 773, 502 U.S. 410, 116 L.Ed.2d 903.
5 Liens encumbering property abandoned by the trustee are not
6 affected in any way by the abandonment and the debtor holds title
7 in the same way as prior to the filing of the bankruptcy. In re
8 Tarpley, 4 B.R. 145 (Bankr.M.D.Tenn.1980).

9 An abandonment is not treated as a transfer of property from
10 the estate to the debtor, but rather a reversion. There are, for
11 example, no tax consequences. 26 U.S.C. § 1398(f)(2); In re
12 Perlman, 188 B.R. 704 (Bankr.S.D.Fla.1995). So, in a
13 hypothetical abandonment, the lienholder cannot really be
14 considered to "receive" any "payment of such debt" in the chapter
15 7 case with respect to its secured claim.

16 An undersecured creditor would receive a distribution, to
17 the extent available, on the unsecured portion of the claim.
18 However, in a case such as the one at hand, that would actually
19 result in Junior Lienholder receiving less "payment of such debt"
20 in this chapter 7 than if the Transfers had not been made. As
21 discussed above, the Transfers resulted in Junior Lienholder's
22 security interest increasing, with a resulting decrease in the
23 unsecured claim. Since Junior Lienholder would only receive a

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1 distribution on the unsecured claim, it is not more and, if any
2 distribution is available, it would be less.

3 So, the two possible approaches result in opposite results.
4 The Court has found no express guidance from case law. So far as
5 the Court can determine, no published case discusses the issue.
6 Without binding precedent or persuasion, the Court must decide
7 which of the approaches best achieves the objective of the
8 preference provisions.

9 Generally speaking, the purpose of preference law is to
10 avoid inequitable distribution to creditors in similar positions.
11 As Professor Countryman explained:

12 A policy of preserving classes and of preserving
13 equality within classes does exist, however, and the
14 preference concept is designed to preserve this policy.
15 The function of the preference concept is to avoid
16 prebankruptcy transfers that distort the bankruptcy
policy of distribution. Transfers that do distort this
policy do so without regard to the state of mind of
either the debtor or the preferred creditor.

17 Id. at 748. Collier expresses the same objectives:

18 The purpose of the preference section is twofold.
19 First, by permitting a trustee to avoid prebankruptcy
20 transfers that occur within a short period before
21 bankruptcy, creditors are discouraged from racing to
22 the courthouse to dismember the debtor during the
debtor's slide into bankruptcy..... Second, and more
important, the preference provisions facilitate the
prime bankruptcy policy of equality of distributions
among creditors of the debtor.

23
24 Collier on Bankruptcy, 15th Revised Edition ¶ 547.01 (2006).

25 The primary purpose is to ensure equal treatment for like
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1 situated creditors. Though the elements of preference focus on
2 what the transferee or beneficiary received, that is not the harm
3 that preference law is designed to remedy. Every preference
4 involves, by definition, a transfer to an entity that has a
5 claim. The problem is not that a legitimate creditor with an
6 antecedent debt gets paid what he, she or it was owed. What is
7 objectionable, is that in the case of the preference, the payment
8 to one creditor is made at the expense of others. The transfer
9 reduces the assets available to pay other creditors. That is the
10 harm which preference law was designed to remedy.

11 Looking at our case from the impact on the estate side
12 perspective, we see that the very harm preference law was
13 designed to address did occur in this case. Within the three
14 months before this case was filed, \$41,716.45 in cash which might
15 otherwise have been available to pay unsecured creditors, was
16 transferred to Senior Lienholder and those transfers benefitted
17 Junior Lienholder. Whether the Property is sold and the proceeds
18 distributed to the Senior Lienholder and Junior Lienholder, or
19 the Property is abandoned, the result, from the perspective of
20 the estate, is that \$41,716.45 which would otherwise be available
21 to unsecured creditors has been removed from their reach to the
22 benefit of Junior Lienholder.

23 Of the two approaches discussed above, only the hypothetical
24 liquidation allows the Trustee to avoid the Transfers and remedy

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1 the harm to the estate.

2 This is the result reached by other courts when faced with
3 similar facts. In Prescott, discussed above, the court upheld a
4 preference judgment against a junior lienholder, based upon
5 transfers to the senior lienholder. 805 F.2d at 729-31.

6 In Aulik v. Largent, 295 F.2d 41 (4th Cir. 1961), debtor had
7 sold fraudulent bonds to two claimants A and B. When the fraud
8 was discovered, both demanded satisfaction. A was owed \$10,700
9 and B \$3,000, and neither claim was secured. Debtor's solution
10 was to execute a note for \$13,700 to B, secured by stock, and
11 have B endorse a note to A for \$10,700, all of which occurred
12 within the preference period. The court held that the transfer
13 of the stock was a preference of \$3,000 with respect to B and
14 \$10,700 with respect to A.⁴

15
16 In our case, the Debtor transferred cash to Senior
17 Lienholder, but the result is the same - a \$41,716.45 portion of
18 Junior Lienholder's unsecured claim became secured.

19 In its supplemental brief, Bank of America argues that
20 payments to a partially secured creditor can only be preferential
21 if they are made on the unsecured portion of the claim. The
22 Court finds no support for such a distinction. Section 547(b)(5)
23 merely requires that such creditor "receive more than such

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25 ⁴ Aulik v. Largent, was decided under the Act, which required a showing that the transfer
26 enabled the creditor to obtain a greater percentage of his debt than some other creditor of the same
class. Id. at 45.

1 creditor would receive" had the transfer not been made. There is
2 no distinction between secured and unsecured portions of such
3 claims. Bank of America relies upon Porter v. Yukon National
4 Bank, 866 F.2d 355 (10th Cir. 1989), but that too is unavailing.
5 In fact, the Porter case supports the Trustee's position.

6 In Porter, the debtor was in default on an obligation to
7 bank. The claim was secured by shares of stock in a company
8 owned by the debtor, but the value of the security was less than
9 the debt owed, in other words, bank was undersecured. Within the
10 preference period, debtor and bank replaced the note with a new
11 one. Debtor granted bank a security interest in the original
12 stock, plus additional new collateral. The result was that bank
13 went from being partially secured to fully secured. The
14 bankruptcy estate had insufficient assets to pay all creditors in
15 full. The court held that this satisfied § 547(b)(5). At no
16 point did the court hold that only payments made on the unsecured
17 portion of a claim can be a preference.

18 For these reasons, the Court holds that § 547(b)(5) is met
19 in this case. The Court recognizes that it may be seen as
20 somewhat unfair to require a creditor such as Junior Lienholder
21 to "return" money it never physically "received." We do not know
22 that Junior Lienholder did not ask for the payments to made to
23 the Senior Lienholder, possibly to avert foreclosure. It is
24 possible that a representative of the Junior Lienholder demanded
25 that Debtors make the payments. Of course, as noted above, as a
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1 matter of law, intent does not matter. Second, the Trustee, if
2 successful in establishing a preference, is not required to
3 recover from the Junior Lienholder. Under § 550, the Trustee may
4 recover from the "entity for whose benefit such transfer was
5 made," or the "initial transferee." In this case it makes little
6 difference since the Senior Lienholder and Junior Lienholder are
7 the same entity. However, in cases in which they are separate,
8 it seems that a trustee might find it simpler to recover the
9 transfers from the direct transferee.

10 For all of the reasons discussed, the Court grants the
11 Trustee's motion for summary judgment on the legal issue of
12 whether one, some or all of the Transfers can be preferences as
13 to the Junior Lienholder. Junior Lienholder has raised the
14 defense of ordinary course. This issue is addressed in the
15 separate Order on Junior Lienholder's motion. In short, while
16 Junior Lienholder did not provide sufficient evidence to
17 establish ordinary course for summary judgment, the defense
18 remains viable, and the Court will need additional evidence on
19 the issue.

20 IT IS SO ORDERED.

21 DATED: SEP 25 2013

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25 PETER W. BOWIE, Judge
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