

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF:)
)
JOSHUA & CATHERINE ARCHER,)
)) CASE NO. BK03-41425
Debtor(s).)
)) A03-4076
JOSHUA & CATHERINE ARCHER,)
))
Plaintiffs,) CH. 7
)
vs.)
)
CORNERSTONE BANK, N.A.,)
)
Defendant.)

MEMORANDUM

Trial was held in Lincoln, Nebraska, on March 23, 2004, on the debtors' amended complaint to set aside a preference. Lea Thomas appeared for the debtors, and Kent Rauert appeared for Cornerstone Bank. This memorandum contains findings of fact and conclusions of law required by Federal Rule of Bankruptcy Procedure 7052 and Federal Rule of Civil Procedure 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(F).

The transfers will be set aside and the funds returned to the debtors.

The debtors brought this action under 11 U.S.C. § 522(h), which permits them to bring an avoidance action that could have been brought by the trustee when the trustee does not do so. "A debtor has standing to avoid a transfer if: (1) the property transferred would have been exempt; (2) the property was not transferred voluntarily; and (3) the trustee has not sought to bring an avoidance action." James v. Planters Bank (In re James), 257 B.R. 673, 675 (B.A.P. 8th Cir. 2001). They assert that five loan payments, totaling \$1,319.94, made to Cornerstone Bank ("the bank") within the 90 days prior to filing bankruptcy should be set aside as preferential transfers.

Mr. Archer obtained a personal loan of \$5,000 from the bank in October 2001, using his car as collateral. The loan quickly fell into default because the debtors were unable to make

regular payments. The debtors brought the note current several times, but were not able to keep it current.

When borrowers are delinquent, the bank causes notice of the right to cure the default to be sent to them. If payment is not made, the loan officer then sends a demand letter to the borrowers, notifying them that if the full past-due amount is not paid within a certain number of days, the bank will take whatever legal action is necessary to protect its interest.

The debtors testified that they received default notices from the bank monthly for several months before they filed bankruptcy. They also received demand letters as well as a number of telephone calls as part of the bank's collection efforts.

In February 2003, the debtors owed a significant past-due balance on the note and the bank wanted to be paid. Mrs. Archer used the family's tax refund to pay \$500 to the bank in early February, and another \$500 in mid-February. After a telephone call from the loan officer, Mrs. Archer paid \$100 on March 25, 2003. She then paid \$216.23 on March 28, followed by a \$3.71 payment the same day to account for the late charge owed. She testified she paid the bank with funds that otherwise would have been used for family living expenses.

The debtors filed bankruptcy on April 21, 2003. They subsequently filed a motion to avoid Cornerstone Bank's lien on the car because it impaired the debtors' tool-of-the-trade exemption in the vehicle. After hearing, the car was determined to be exempt as a tool of the trade, its value was fixed at \$2,300, and the lien was avoided.

In the meantime, the debtors filed this adversary proceeding to recover those February and March pre-petition payments as preferences. Section 547(b) permits the transfer of a debtor's interest in property to be avoided if it was made

- (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).

As a threshold matter, I find that debtors have met the three James factors for standing. The money paid to Cornerstone Bank would either have been used for other pre-petition payments or it likely would have been exempt under Neb. Rev. Stat. § 25-1552 if it had been in the debtors' possession on the petition date. The transfers appear to have been involuntary, as representatives of the bank stated repeatedly in verbal and written correspondence to the debtors that the bank would take any legal action necessary to protect its interest. The debtors reasonably interpreted that to include the possibility of repossession. Finally, the trustee has abandoned all assets of the estate without instituting an action to recover these payments.

In this case, all five elements of § 547(b) have been met.¹ Admittedly, at first blush, it would appear that Cornerstone Bank, as a fully secured creditor, could not have received a preferential transfer because it did not receive any more than it would have in a Chapter 7 proceeding. However, the order avoiding the lien changed the bank's status in this case.

Section 522(f) avoids "the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption". This means that the pre-petition attachment of the lien is rendered void and the creditor retroactively becomes unsecured. Because the effect of a preferential transfer is determined as of the petition date, a secured creditor whose lien has been avoided is treated as an unsecured creditor in the administration of the estate. See Vern Countryman, The Concept of a Voidable Preference in Bankruptcy, 38 Vand. L. Rev. 713, 745-46 (1985):

¹For purposes of avoiding transfers, a debtor is presumed to have been insolvent during the 90 days preceding the petition date. 11 U.S.C. § 547(f).

[When] a creditor seeks to meet the preference challenge by asserting that he was fully secured at the time of the challenged payment, . . . the creditor still may be vulnerable to a two-step attack by the party invoking section 547. If that party can avoid the defendant creditor's lien, then the challenged transfer becomes one made to an unsecured creditor and has a preferential effect unless this creditor would receive 100% in a Chapter 7 distribution. Benedict v. Ratner, [268 U.S. 353 (1925),]. . . established the attack.

The same observation was made in dicta in Washkowiak v. Glenwood Medical Group (In re Washkowiak), 62 B.R. 884 (Bankr. N.D. Ill. 1986), where the debtors were seeking to recover a payment they had made to the creditor to satisfy a judgment lien so they could clear the title to a parcel of real estate in order to sell it. The creditor asserted that it was fully secured and would have received a 100 percent payout in a Chapter 7, so the payment at issue could not have put it in a better position that it would otherwise have been in. The court noted, "Thus, the focus becomes the validity of Glenwood's lien. If the lien can be avoided, Glenwood, in effect, retroactively becomes unsecured and payments to a nonpriority unsecured creditor on the eve of bankruptcy are almost inevitably voidable as preferences." 62 B.R. at 886.

In this case, that is precisely what happened. Cornerstone Bank's lien was avoided because it impaired the value of the debtors' exemption in the vehicle. As a result, the bank retroactively became unsecured. Therefore, the payments it received from the debtors within the 90 days prior to the petition date caused it to receive more than it would have received as an unsecured creditor in this no-asset Chapter 7 case. The transfers made in February and March 2003, totaling \$1,319.94, are preferential and should be refunded by the bank to the debtors.

Separate judgment will be entered.

DATED: April 12, 2004

BY THE COURT:

/s/ Timothy J. Mahoney
Chief Judge

Notice given by the Court to:

*Lea Thomas
Kent Rauert
U.S. Trustee

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

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Defendant.)

JUDGMENT

Trial was held in Lincoln, Nebraska, on March 23, 2004, on the debtors' amended complaint to set aside a preference. Lea Thomas appeared for the debtors, and Kent Rauert appeared for Cornerstone Bank.

IT IS ORDERED: Judgment is hereby entered in favor of the plaintiff debtors and against the defendant. The preferential transfer is avoided. Cornerstone Bank, N.A., shall refund the sum of \$1,319.94 to the debtors. See Memorandum entered this date.

DATED: April 12, 2004

BY THE COURT:

/s/ Timothy J. Mahoney
Chief Judge

Notice given by the Court to:

*Lea Thomas
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