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FOR THE DISTRICT OF UTAH

Central Division

In re	
PAYLESS BUILDING & REMODELING, INC., a Utah corporation	Bankruptcy No. B-79-00107
Bankrupt	
KENNETH A. RUSHTON, Trustee	
Plaintiff	MEMORANDUM AND ORDER
vs	
PAULINE M. ADAMS	
Defendant	

This case was submitted to the Court on stipulation of facts and without oral argument. Kenneth A. Rushton represented himself as trustee. Paul N. Cotro-Manes represented the defendant, Pauline M. Adams. The Court now renders the following decision which incorporates its findings of facts and conclusions of law.

According to the stipulation on November 1, 1978, Pauline M. Adams, the defendant, made a temporary unsecured loan of $3,000 to Payless Building & Remodeling, Inc., hereinafter referred to as Payless. The loan was for the specific purpose of allowing Payless to complete a remodeling job for William Duncan, hereinafter referred to as the Duncan job. Although the Duncan job was never totally completed, Payless received payments for the job on October 27, 1978 in the amount of $5,075, on November 2, 1978 in the amount of $4,500, and on November 10, 1979 in the amount of $4,000.

On November 21, 1978, Payless made a partial repayment to defendant in the amount of $2,000. On December 18, 1978, Payless made a final repayment on the loan in the amount of $1,000. The defendant knew or had reason to know that at the time of the repayment Payless was insolvent.

On February 21, 1979, Payless filed a petition in bankruptcy with this Court. On April 6, 1979, the trustee instituted this action against the defendant to set aside the repayments to the defendant on the grounds that they constituted voidable preferences under §60 of the Bankruptcy Act, 11 U.S.C. §96 (1976).

Briefly stated the elements of a voidable preference under §60 consist of the following: (1) there must be a transfer of the bankrupt's property, (2) to or for the benefit of a creditor, (3) for or on account of an antecedent debt (resulting in a depletion of the estate), (4) while insolvent, and while the creditor benefitted had reasonable cause to believe the debtor was insolvent, (5) within four months of bankruptcy, (6) the effect of which is to enable the creditor to obtain a greater percentage of his debt than some other creditor of the same class. See 3 Collier on Bankruptcy, ¶60.02, at 759 (14th ed. 1976).

The parties have stipulated that the bankrupt corporation on November 21, 1978 and December 18, 1978 made payments (transfers) to the defendant, in amounts of $2,000 and $1,000 respectively, as repayments on an unsecured loan made by the defendant on November 1, 1978. The parties have also stipulated that the transfers were made within four months of bankruptcy, while the bankrupt was insolvent, and that when the transfers were made, the defendant knew or had reasonable cause to believe that the bankrupt was insolvent. Since it was further agreed that the defendant received a greater percentage of her debt (100 percent) than would other unsecured creditors at the time bankruptcy was filed, the only issue in dispute concerns whether the repayment of the loan depleted the estate of the bankrupt.

The defendant initially argued that because the loan allowed the bankrupt to finish the Duncan job and receive additional payments on the Duncan account, there cannot be a depletion of the estate. This line of reasoning is based upon a misconception as to what constitutes a transfer. The two payments are separate transactions from the original loan. They were not made, nor meant to be made, contemporaneously and therefore are not to be lumped together. Each transaction must therefore stand on its own when under scrutiny by the trustee. It is the repayments which are being challenged as voidable preferences, and not a combination of loan and repayments.

While the length of time between the loan and the two repayments was only three weeks and six weeks respectively, the duration of the loan is not significant under existing bankruptcy law. In National City Bank v. Hotchkiss, 231 U.S. 50 (1913), the Supreme Court held that even when an unsecured creditor receives full repayment within five hours of making a loan, such repayment is still a voidable preference.

The depletion question then principally turns on whether or not the repayments were made to extinquish some perfected interest that the defendant held in the property of the bankrupt. If made in exchange for the release of a perfected interest, no depletion of the estate results. See 3 Collier on Bankruptcy ¶60.36, at 913 (14th ed. 1976). Since the only property of Payless that was even discussed in relation to the loan was the Duncan account, this inquiry can be confined to a determination of whether the defendant ever acquired a perfected interest in the Duncan account. If the original loan was not given in exchange for some perfected interest in the Duncan account, then the repayment of the loan could not have been a release of that interest. The repayment therefore would deplete the estate and be susceptible to attack as a voidable preference.

The defendant has not claimed, nor is there any evidence, that she obtained an interest in the Duncan account which would qualify as a perfected security interest under Article 9 of Utah's version of the Uniform Commercial Code, UTAH CODE ANN. §70A-9-101 et seq. (1977). In the present circumstances,

UTAH CODE ANN. §70A-9-203 (1977), U.C.C. §9-203, requires a security agreement signed by the debtor (Payless) which contains a description of the collateral (Duncan account) as a minimum prerequisite to obtaining a perfected security interest. The defendant has not brought any qualifying written instrument to the attention of this Court and has in fact, stipulated that the loan was unsecured.

Article 9, however, does not end our inquiry into this matter. If the defendant acquired an equitable lien which meets the standards of §60a(6) of the Bankruptcy Act, 11 U.S.C. §96a(6) (1976), then the repayment would be in satisfaction of an equitable lien and not a voidable preference. See 3 Collier on Bankruptcy ¶60.50, at 1038 (14th ed. 1976).

Prior to 1938, the United States Supreme Court held that an equitable lien was a sufficiently perfected interest such that repayment of the debt it secured did not constitute a voidable preference. Sexton v. Kessler & Co., 225 U.S. 90 (1912). The 1938 amendments to the Bankruptcy Act substantially eliminated equitable liens as security for debts and repayments of such debts were treated as voidable preferences. 52 Stat. 869 (1938). See also Corn Exchange Nat'l Bank & Trust v. Klauder, 318 U.S. 434 (1943). Subsection a(6) was added in 1950 to allow recognition of some equitable liens. This recognition, however, was carefully limited by terms of the subsection itself:

> The recognition of equitable liens where available means of perfecting legal liens have not been employed is hereby declared to be contrary to the policy of this section . . . .

In Porter v. Searle, 228 F.2d 748 (10th Cir. 1955), the Tenth Circuit found circumstances establishing an equitable lien under Utah law which met the requirments of §60a(6) of the Bankruptcy Act. Porter involved an attempt by the trustee to set aside the bankrupt's transfer of certain merchandise to the defendants, the Searles, as a voidable preference. The Searles had sold the merchandise to Abe Greenband for a downpayment and a promise to secure the unpaid balance by a chattel mortgate. When the Searles asked Greenband to sign the chattel mortgage, he refused. Shortly thereafter, and within four months of an involuntary petition being filed against Greenband, Greenband surrendered to the Searles the merchandise in satisfaction of the balance due on the sale of the merchandise. The Court held that, under Utah law, the Searles had a perfected equitable lien in the merchandise as to the time Greenband refused to execute the chattel mortgage. The Searles' equitable lien satisfied the requirements of §60a(6) because they had no available means of perfecting their interest in the merchandise. The Porter Court therefore held that the transfer of the merchandise to the Searles was given in exchange for the equitable lien and was not a voidable preference.

The stipulated facts of the case at bar specifically state that the loan from the defendant to Payless was unsecured. There is no indication that the defendant attempted to secure the loan akin to the Searles' attempt in Porter. There is no evidence that the defendant was ever promised a security interest by Payless or that Payless later refused to execute the security agreement. The defendant has not even submitted evidence of having asked Payless for a written agreement to evidence the granting of an interest in the Duncan account.

Thus, in contrast to the Searles in Porter, the defendant here had available legal means to perfect an interest in the Duncan account and failed to do so. If the defendant had requested and received from Payless a writing which met the requirements of UTAH CODE ANN. §70A-9-203 (1977), namely a writing signed by Payless's authorized representative and describing the Duncan account, then she may well have had a perfected security interest in the account even without filing. Under UTAH CODE ANN. §70A-9-302(1)(e)(1977), a financing statement need not be filed in connection with an assignment of accounts which does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts of the assignor. This provision of the Uniform Commercial Code has been interpreted to exclude from the filing requirement a "one-shot deal" such as the assignment to the defendant here of the Duncan account. See Consolidated Film Industries v. United States, 547 F.2d 533 (10th Cir. 1977). See also Case Comment, Assignment of Accounts and Contract Rights, 1977 UTAH L.REV. 331; 3 Collier on Bankruptcy ¶60.51A, at 1050.9 (14th ed. 1976). Because the defendant had available legal means to perfect her interest in the Duncan account and did not employ them, she did not acquire an equitable lien in the Duncan account which would satisfy §60a(6) of the Bankruptcy Act. Since the defendant did not have either a perfected security interest or an equitable lien, the loan repayments cannot be considered a release of such interests. The loan repayments therefore, depleted the estate of the bankrupt corporation and hence, were voidable preferences under §60 of the Bankruptcy Act.

Having decided that the defendant would not qualify for an equitable lien that would satisfy §60a(6) of the Bankruptcy Act, it is not necessary for this Court to decide whether the kind of equitable lien recognized in Porter has continuing vitality under the subsequently adopted Uniform Commercial Code. The courts are split on the question of whether or not the Uniform Commercial Code eliminated the doctrine of equitable liens. See e.g., Shelton v. Erwin, 472 F.2d 1118 (8th Cir. 1973). (Since the Uniform Commercial Code reduces formal requisites for creation of a security interest to a minimum, the doctrine of equitable liens is no longer necessary or useful in Missouri commercial law.) Contra, General Insurance Co. of Am. v. Lowry, 570 F.2d 120 (6th Cir. 1978). (Ohio's doctrine of equitable liens survived Ohio's adoption of the Uniform Commercial Code.)

The defendant, in her memorandum, directed the Court's attention to Tiffany v. Boatman's Saving Inst., 85 U.S. 375

(1873), to support the claim that it is not forbidden for someone to loan to a debtor in financial difficulties. The Court notes that Tiffany involved loans where collateral was taken as part of the original loan and the principal issue was whether usurious rates would invalidate the transfer of the collateral. The loans in Tiffany were held to be secured and hence the repayments on the loans were not voidable preferences. In contrast, the loan involved in the case at bar was unsecured and the repayments are therefore voidable preferences.

The defendant also directs the Court's attention to Mills v. Virginia-Carolina Lumber Co., 164 F. 168 (4th Cir. 1908). In Mills, the trustee claimed that the Virginia-Carolina Lumber Co. had received a preference for being allowed to pick up certain lumber which it had purchased from the bankrupt. The court in Mills found the sale of the lumber to be a cash sale and not a loan. Therefore, as this proceeding is concerned with an unsecured loan and not a cash sale, there exists no analogy between the two cases.

ORDER

Pursuant to the foregoing, IT IS ORDERED THAT plaintiff's complaint for judgment in the sum of $3,000 with interest thereon from this date be, and it is, granted. Judgment shall be entered in accordance with this memorandum decision and order.

DATED this 12 day of June, 1980.

Ralph R. Mabey
United States Bankruptcy Judge

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