UNPUBLISHED OPINION

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IN THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF UTAH

NORTHERN DIVISION

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IN RE:	)	Bankruptcy No. 84A-00667
SHELLY DAWN OROSCO,	)	
Debtor.	)	
SHELLY DAWN OROSCO,	)	Adversary Proceeding No. 84PA-1409
Plaintiff,	)	
vs.	)	
VETERANS ADMINISTRATION OF THE UNITED STATES,	)	
Defendant.	)	

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MEMORANDUM OPINION

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APPEARANCES

Gerald S. Wight, Ogden, Utah, for the plaintiff; Barbara W. Richman, Assistant United States Attorney for the defendant.

CASE SUMMARY

This is an adversary proceeding in which the plaintiff, a Chapter 13 debtor, invokes 11 U.S.C. §547 in order to avoid the prepetition foreclosure sale of her residence. The Court determined in an earlier ruling that the debtor is procedurally entitled to utilize the avoiding powers of Section 547. In re Orosco, 84P-1409,

unpublished memorandum opinion (Bkrtcy. D. Utah, November 30, 1984). The substantive merits of the debtor's case are the subject of the present opinion. For the reasons set forth below, the Court finds that the debtor is not entitled to recovery under Section 547 but that the facts of the case support recovery under Section 548.

FACTUAL AND PROCEDURAL BACKGROUND

The prepetition transfer in dispute involves the debtor's former residence. She acquired the home on May 15, 1981 by warranty deed from Lysle Craig English and Annette English. The debtor took the property subject to a trust deed which the Englishes had executed in favor of United Savings & Loan. This trust deed secured a purchase-money loan that the Englishes had obtained in order to buy the home in April of 1978. the loan to the Englishes was evidenced by a promissory note payable to the order of United Savings and Loan Association in the amount of $41,500.00 at eight and three-quarters percent per annum interest. United Savings and Loan Association later negotiated the note to the Federal National Mortgage Association ("FNMA"). The defendant, the Veterans Administration ("VA") was guarantor of the Englishes' obligation on the note.

Although the debtor bought the Englishes' home, she never assumed their loan. She simply took the home subject to the Englishes' trust deed. The Englishes remained liable as obligors on the note at all times. By purchasing the home subject to the prior trust deed, the debtor's incentive to make payments on the Englishes'

loan was that failure to do so would result in foreclosure. She was not personally liable on the loan. She would not in anyway be responsible for a deficiency in the event of foreclosure.

The debtor made monthly payments on the Englishes' note until July of 1983 when she defaulted. FNMA sold the home to the VA at a foreclosure sale on March 8, 1984. The deed was delivered and recorded on the same day as the sale. The VA paid $43,222.29 in cash for the house, the exact amount of the outstanding indebtedness for which the VA, as guarantor for the Englishes, was liable.[1]

On March 9, 1984, the day following the sale, the debtor filed a petition under Chapter 13 of the Bankruptcy Code. She now attempts to bring her former residence back into the bankruptcy estate on the grounds that the foreclosure sale was a voidable preference under Section 547.

The evidence includes various estimates as to the value of the home. The VA submitted an appraisal reporting the value at $51,000.00 "as is" and $52,000.00 "as repaired". The debtor listed the home's value at $55,600.00 in her schedules, but, at trial,

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1 The VA alleged in its memorandum that it paid $43,377.34 to purchase the home. However, the trustee's deed recorded after the sale reported that the VA paid $43,222.29. The Court considers the latter figure to be more reliable.

debtor's counsel represented the value to be $59,000.00. The parties stipulated that each of these figures could be considered in evidence.

DISCUSSION

Subsection (b) of Section 547 contains the general elements of voidable preferences. Relevant portions of that subsection provide:

> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of property of the debtor --
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> (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 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.

Every element of a preference must be proven in order to recover under Section 547. In re Independent Clearing House Co., 41 B.R. 985, 1009-10, 12 B.C.D. 44 (Bkrtcy. D. Utah 1984).

In denying that its purchase of the debtor's home was a preference, the VA maintains that two of the elements of Section 547 are missing: (1) that the VA is not and never was a creditor of the debtor, and (2) that the VA did not receive more by purchasing the home at the trustee's sale than it would have been entitled to in a liquidation under chapter 7. Assuming arguendo that the VA is a creditor of the debtor, the Court addresses the second argument first.

In order to determine whether a creditor has received more than he would under chapter 7, the Court must find that a chapter 7 distribution would pay the creditor less than 100 percent of his claim. Palmer Clay Product Co. v. Brown, 297 U.S. 227, 229 (1936); In re Independent Clearing House, Inc., supra, 41 B.R. at 1013.

Since a fully secured creditor is entitled to receive the entire amount of his claim, courts have generally found that transfers to such creditors do not constitute preferences. See, eg., Matter of Formed Tubes, Inc., 41 B.R. 819, 12 B.C.D. 331 (Bkrtcy. E.D. Mich. 1984); In re Santoro Excavating, Inc., 32 B.R. 947, 10 B.C.D. 1369 (Bkrtcy. S.D. N.Y. 1983); Matter of Derritt, 20 B.R. 476, 9 B.C.D. 481 (Bkrtcy. N.D. Ga. 1982); Matter of Lackow Bros., Inc., 19 B.R. 601, 8 B.C.D. 1367 (Bkrtcy. S.D. Fla. 1982); Matter of Community Hospital of Rockland County, 15 B.R. 785 (Bkrtcy. S.D. N.Y. 1981);

Matter of Hale, 15 B.R. 565, 8 B.C.D. 434 (Bkrtcy. S.D. Ohio 1981); In re Castillo, 7 B.R. 135 (Bkrtcy. S.D. N.Y. 1980); In re Zuni, 6 B.R. 449, 6 B.C.D. 1222 (Bkrtcy. D.N.M. 1980).

In this case, the claim in question was secured by a trust deed on the debtor's home. The evidence shows that this trust deed was not the only encumbrance on the property but that it was in first position. Foreclosure of it would extinguish subordinate liens. The amount of the indebtedness was $43,222.29. Estimates as to the value of the property range from a low of $51,000.00 to a high of $59,000.00. Clearly, the debt was fully secured. Assuming that the VA was a creditor of the debtor, it would thus be entitled to 100 percent of its claim in a chapter 7 distribution. The Court concludes, therefore, that there was no preference. There is no need to discuss the other argument about whether the VA was in fact a creditor of the debtor.

However, the Court is constrained to give further consideration to this case with regard to a possible fraudulent transfer under Section 548. Although the parties did not argue this theory, the Court has power to consider it under Rule 15 of the Federal Rules of Civil Procedure, made applicable in adversary proceedings by Rule 7015 of the Bankruptcy Rules. Rule 15(b) provides in pertinent part:

> (b) Amendments to Conform to the Evidence. When issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in

> the pleadings. Such amendment of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time, even after judgment; but failure so to amend does not affect the result of the trial of these issues.

(Emphasis added.)

This rule adopts the equitable policy that litigation should be resolved on the merits; it rejects any concept that recovery is barred where a post-trial amendment to the pleadings would result in a change of the plaintiff's legal theory or the nature of his cause of action. 3 Moore's Federal Practice ¶15.13[2] at 15-162 (2d Ed. 1984). It also makes immaterial whether an amendment is actually made. Id. at 15-169.

Furthermore, if the evidence warrants application of Rule 15(b), the Court is, by the rule's own terms, obligated to apply it. Accordingly, the Court has a duty in this case to consider alternative theories of recovery that are supported by the evidence. Cf. Matter of Evans Potato Co., Inc., 44 B.R. 191 (Bkrtcy. S.D. Ohio 1984) (holding that plaintiff could prevail under Section 548 even though the parties pleaded and argued the elements of Section 547 only)

In considering Section 548 as an alternative theory of recovery, the Court extends the rationale of its earlier decision, In re Orosco, supra, 84P-1409, unpublished memorandum opinion (Bkrtcy. D.

Utah November 30, 1984), in holding that this Chapter 13 debtor is procedurally entitled to utilize the avoiding powers not only of Section 547 but of Section 548 as well.

Relevant portions of Section 548 provide:

> (a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor --
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> * * *
>
> (2)(A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
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> (B)(i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation.

The Court's discussion will focus on whether the debtor received "less than a reasonably equivalent value "in exchange for her home. All other elements necessary for recovery under this section are unquestionably present.

In re Richardson, 23 B.R. 434, 9 B.C.D. 895 (Bkrtcy. D. Utah 1982) established the law in this district with respect to avoiding foreclosure sales under Section 548(a)(2). In that case, the trustee brought an adversary proceeding to avoid the prepetition foreclosure sale of real property. The trustee alleged causes of action under Sections 544 and 548 of the Code. The Court adopted the rationale of

Durrett v. Washington National Insurance Co., 621 F.2d 201 (5th Cir. 1980) in holding that Section 548(a)(2) allows the trustee to avoid foreclosure sales where the sale price is less than a reasonably equivalent value. The Court rejected the reasoning of In re Madrid, 21 B.R. 424 (9th Cir. App. Pan. 1982), aff'd, 725 F.2d 1197 (9th Cir. 1984), which held that the sale price at a properly conducted foreclosure sale is deemed to be a reasonably equivalent value. Richardson noted: "[I]n cases where another measure of value is available, the price obtained at foreclosure is weak evidence of value."[2]

In this case, other measures of value are available. The most conservative of these is FNMA's appraisal report prepared in anticipation of the trust deed sale. It lists the fair market value of the debtor's home at $51,000.00 "as is". The price paid by the VA at the sale was $43,222.29 -- almost $8,000.00 below FNMA's estimate. This discrepancy is significant, given that the other evidence suggests that the home might be worth more than $51,000.00. Accordingly, the Court concludes that the VA did not pay a reasonably equivalent value for the debtor's home.

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Some courts have interpreted Durrett and Madrid as defining resonable equivalence in terms of a certain percentage of fair market value. See In Re Richardson, supra, 23 B.R. at 448 n. 21. Richardson, however, did not accept this approach. Instead, the Court stated: "[R]easonable equivalence will depend on the facts of each case. In some cases, no less than 100 percent of fair market value may be a reasonable price." 23 B.R. at 448.

The other elements of a fraudulent transfer being present, the Court finds that the trust deed sale of the debtor's home to the VA is voidable under Section 548.

WHEREFORE, IT IS ORDERED that the transfer of the debtor's home to the VA be, and is hereby, declared null and void.

DATED this 15 day of May, 1985.

John H. Allen

JOHN H. ALLEN
UNITED STATES BANKRUPTCY JUDGE