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UNPUBLISHED OPINION

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF UTAH

In re	)	
	)	
GRANADA, INC.,	)	Bankruptcy Case No. 87C-00693
	)	
Debtor.	)	
	)	
	)	
PETER W. BILLINGS, JR., Trustee for Granada, Inc.,	)	Adversary Proceeding No. 89PC-0401
	)	
Plaintiff,	)	
	)	
vs.	)	
	)	
RICHARDS WOODBURY MORTGAGE CORPORATION, VIRGINIA BEACH FEDERAL SAVINGS BANK, and VIRGINIA BEACH SAVINGS & LOAN ASSOCIATION,	)	
	)	
Defendants.	)	MEMORANDUM OPINION AND ORDER

The matter presently before the court is a motion by Peter W. Billings, Jr., Esq., the Chapter 11 trustee ("trustee"), for summary judgment of the above-entitled adversary proceeding. A hearing was held on August 9, 1990. Robert P. Rees, Esq. appeared on behalf of the trustee. Bryce D. Panzer, Esq. appeared on behalf of the defendants.

Counsel presented argument after which the court took the matter under advisement. The court has carefully considered and reviewed the memoranda submitted by the parties and the arguments of counsel, and has made an independent review of the pertinent authorities. Now being fully advised, the court renders the following decision denying the trustee's motion for summary judgment.

FACTS

On February 13, 1987, Granada, Inc. ("Granada") filed a petition for relief under Chapter 11 of the Bankruptcy Code. On June 22, 1987, the court appointed the trustee. On June 20, 1989, the trustee filed a complaint in this court instituting the present adversary proceeding against the defendants alleging that certain payments that Granada had made to the defendants during the prepetition year are avoidable as preferential transfers under 11 U.S.C. § 547(b)[1] and that the value of those transfers is recoverable by him under § 550(a).[2] The defendants deny that the transfers are preferential and that they are parties from whom recovery can be sought under § 550(a). In addition, the defendants have raised defenses under § 547(c)(1), (2) and/or (4).

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[1]Unless otherwise stated, all future references to statutory sections are to Title 11 of the United States Bankruptcy Code.

[2]The court is referring to the trustee's amended complaint.

(a) The Parties and the Debt in Question

Relevant to this proceeding is Granada's general partnership interest in Layton M-1 Associates ("Layton"), a Utah limited partnership. Layton has filed a petition for relief under Chapter 7 of the Bankruptcy Code. Also pertinent to this proceeding is Granada's participation with Layton in a joint venture known as the "Layton Industrial Park Joint Venture" ("joint venture"). The joint venture was formed to develop a parcel of land located in Layton, Utah, commonly known as the "Layton Industrial Park." (Stipulation ¶ 3.) Granada and Layton each held an undivided one-half interest in the Layton Industrial Park land. (Stipulation ¶ 2(e).)

On or about January 28, 1983, Richards Woodbury Mortgage Corporation ("RWM") extended a loan in the original principle amount of $1,035,000.00 to Granada and Layton. The note evidencing the loan provides that Granada and Layton are jointly and severally liable. (Stipulation, ¶ 2(a); Exhibits "A" & "B".) The loan was secured by a trust deed on the Layton Industrial Park land. (Exhibit "C".) C. Dean Larsen ("Larsen") and J. Gary Sheets guaranteed the loan. (Exhibit "D".) At all relevant times, Larsen was the president of Granada.

Shortly after originating the loan, RWM sold it to Virginia Beach Federal Savings Bank ("Virginia Beach"). RWM continued, however, to service the loan as Virginia Beach's servicing agent and checks on account of the loan were made payable to RWM. On November 2, 1989, the parties stipulated that RWM be dismissed from this

proceeding and, therefore, all of the payments on the loan in question are considered to have been made directly to Virginia Beach. (Stipulation ¶ 32.)

(b) Granada's Method of Operation and the Transfers in Question

Granada's method of operation is more fully set out in *Billings v. Key Bank of Utah (In re Granada)*, 115 B.R. 702 (Bankr. D. Utah 1990). For purposes of this opinion it is sufficient to state that Granada operated an interoffice account from which it upstreamed and downstreamed funds to cover its expenses and the expenses of the limited partnerships in which it held an interest. During the prepetition year Granada downstreamed the following funds from its interoffice account to one of the joint venture's bank accounts:

Date	Amount
3-27-86	$ 22,000.00
4/15/86	$ 9,450.00
7/29/86	$ 10,000.00
9/8/86	$100,000.00
10/20/86	$ 8,610.00
12/12/86	$ 9,050.00
12/30/86	$ 8,800.00

(Stipulation ¶ 27; Exhibit "I".) The joint venture then made the following payments on the Granada-Layton loan to Virginia Beach:

Posted Date	Date Cleared	Amount
3/20/86	3/28/86	$ 19,349.07
4/17/86	4/17/86	$ 9,406.12
7/29/86	7/30/86	$ 9,557.84
9/12/86	9/15/86	$100,000.00
10/24/86	10/20/86	$ 8,605.98

12/08/86	12/17/86	$ 9,025.45
1/02/87	12/30/86	$ 8,734.31

(Stipulation ¶ 28; Exhibits "I" & "J".) At the time that the joint venture received the funds from the Granada interoffice account, it did not have sufficient funds on deposit in its checking accounts to enable the bank to honor the checks payable to RWM. (Stipulation ¶ 30.) Each of the transfers from Granada's interoffice account to the joint venture's checking accounts were recorded on the books of the joint venture as a loan payable by the joint venture. (Stipulation ¶ 35.) When it upstreamed funds from the joint venture's checking account, Granada would record the transaction on its books as a loan receivable to the interoffice loans from the joint venture. (Stipulation ¶ 35.) Granada employees maintained the balance sheets, financial statements, and other records of Granada, Layton, and the joint venture. (Stipulation ¶ 10.) All of the checks that were drawn on the joint venture's checking accounts were signed by Granada employees. (Stipulation ¶ 18.)

The parties have stipulated that Granada was insolvent during the prepetition year. (Stipulation ¶ 13.) The parties have also stipulated that:

> During the year preceding the filing of Granada's Chapter 11 petition, the Layton Industrial Park land subject to the Trust Deed had a fair market value in excess of the entire balance of the Loan. However, during the prepetition year, the value

> of Granada's one-half interest in the property (as reflected in the records of the Davis County Recorder) was less than the entire balance of the Loan.

(Stipulation ¶ 14.)

On the basis of these facts, the trustee argues that the downstream transfers that Granada made to the joint venture should be collapsed and that they should be deemed to have been made by Granada to Virginia Beach. *Billings v. Key Bank of Utah (In re Granada)*, 115 B.R. 702 (Bankr. D. Utah 1990). He then argues that the transfers are avoidable as preferences under § 547(b). He maintains that because Larsen, the guarantor of the loan, is an insider, the one year reach-back provision of § 547(b)(4)(B) should apply. As avoidable transfers, the trustee contends that under § 550(a) he may recover the property that was transferred for the benefit of the estate from Virginia Beach as a transferee under that section.

DISCUSSION

The threshold issue in this proceeding is whether a preference exists. With the exception of § 547(b)(5), the facts as stipulated to by the parties indicate that the trustee has established a preference cause of action against Virginia Beach. Specifically, during the prepetition year, while Granada was insolvent, monies from its interoffice account were transferred to the joint venture who in turn transferred the monies to Virginia Beach to benefit Larsen who is an insider and who is a creditor of

the estate by virtue of his guaranty of the loan in question. *See Billings v. Key Bank of Utah (In re Granada)*, 115 B.R. 702 (Bankr. D. Utah 1990); *Billings v. Zions First Nat'l Bank (In re Granada)*, 110 B.R. 548 (Bankr. D. Utah 1989). The trustee, however, has not established § 547(b)(5) inasmuch as he has stipulated that the Layton-Granada loan is oversecured.

Section 547(b)(5) requires that the transfer in question enable the 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." In analyzing § 547(b)(5), "the court must construct a hypothetical liquidation of the debtor's estate. ... [A preference will exist only if] the preferred creditor, if paid to the extent provided by the Bankruptcy Code, would receive less than 100 percent of its claim." *Merrill v. Abbott (In re Independent Clearing House Co.)*, 41 B.R. 985, 1013 (Bankr. D. Utah 1984), *rev'd in part on other grounds*, 62 B.R. 118 (D. Utah 1986). It is generally settled that "payments to a fully secured creditor will not be considered preferential because the creditor would not receive more than in a Chapter 7 liquidation." 4 COLLIER ON BANKRUPTCY ¶ 547.08 at 547-43 (15th Ed. 1990); *see also In re Rimmer Corp.*, 80 B.R. 337, 339 (Bankr. E.D. Pa. 1987); *In re Zuni*, 6 B.R. 449 (Bankr. D.N.M. 1980). "The underlying rationale for this rule is 'that to the extent a secured creditor holding valuable collateral receives payment prior to bankruptcy, the

amount of the secured claim is proportionately reduced.'" *In re Hale*, 15 B.R. 565, 567 (Bankr. S.D. Ohio 1981) (quoting *In re Hawkins Mfg., Inc.*, 11 B.R. 512, 513 (Bankr. D. Colo. 1981)). The estate, however, is not diminished. *See Coral Petroleum, Inc. v. Banque Paribas-London*, 797 F.2d 1351, 1356-57 (5th Cir. 1986) (discussing the earmarking doctrine, the court states that a preference will not exist absent a diminution of the assets available for unsecured creditors); *Deel Rent-A-Car, Inc. v. Levine*, 721 F.2d 750, 756 (11th Cir. 1983) ("The fact that one creditor is paid in full from a source to which other creditors have no right to resort, does not entitle ... the trustee to recover the amount so secured.")

Recognizing the principles set forth by the court, the trustee argues that the court should look to whether *Granada's* interest in the property oversecured the debt. Specifically, the trustee maintains that § 547(b)(5) has been satisfied because Granada's one-half interest in the Layton Industrial Park land does not oversecure the loan and unsecured creditors in this case will not receive a 100 percent dividend from the estate. The court does not agree with the trustee that for purposes § 547(b)(5) it should only consider Granada's one-half interest in the land. In a hypothetical liquidation case, Virginia Beach would have been able to seek relief from the automatic stay under § 362(d) to foreclose on the Layton Industrial Park land or the trustee would have sold the property pursuant to § 363(h). The fact that Layton held an interest in the property would not have prevented Virginia Beach from fully recovering its claim.

Because Virginia Beach's claim would have been satisfied from the property collateralizing its loan, Granada's prepetition transfers did not diminish the estate and, therefore, the trustee is not entitled to summary judgment.[3] Based on this conclusion, the court need not address the remaining issues raised by the parties.

Accordingly, it is HEREBY ORDERED that the trustee's motion for summary judgment be DENIED.

DATED this 29 day of October, 1990.

BY THE COURT:

GLEN E. CLARK, CHIEF JUDGE
UNITED STATES BANKRUPTCY COURT

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[3]Indeed, if Virginia Beach were compelled to pay the amount sought by the trustee in this proceeding, the trustee, in recognition of Virginia Beach's first priority secured position, would simply be required to repay the funds collected to Virginia Beach.

In support of his argument, the trustee cites *In re Herman Cantor, Corp.*, 15 B.R. 747 (Bankr. E.D. Vir. 1981). In that case, the debtor sought to avoid a transfer that it had made to a secured creditor under 11 U.S.C. § 547(b). The creditor thereafter moved to dismiss the complaint for failure to state a cause of action. The court found a preference despite the fact that the debt was fully secured by an investment certificate that was pledged by a principle of the company. In so holding, the court cited *In re Zuni*, 6 B.R. 449, 452 (Bankr. D.N.M. 1980) for the proposition that "[a]lthough CFB held a fully secured claim, it appears that CFB enjoyed a preference because payment to the secured creditor was not 'accompanied by the release of an equivalent value to the estate.'" *Herman Cantor*, 15 B.R. at 749. This court declines to follow the reasoning in the *Herman Cantor* case because it misreads the holding in *Zuni*. In *Zuni*, the court stated that payment on account of an oversecured loan will never be preferential. The court went on to state that transfers on account of a secured creditor's debt which is undersecured may be preferential.