UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In Re: Chapter 7

Matthew Mark Higgins BKY NO: 03-36033
Amy Beth Higgins
fka Amy Beth Meyer,

Debtor(s).

Charles W. Ries, Trustee,

Plaintiff, ADV NO: 04-3247

vs.

Rochester Motor Company,
dba Rochester Ford, and
Affinity Plus Federal Credit Union,

Defendants.

TRUSTEE RIES' MEMORANDUM OF LAW
IN OPPOSITION TO
DEFENDANT'S MOTION FOR SUMMARY JUDGMENT AND
MOTION FOR SUMMARY JUDGMENT

INTRODUCTION

This Memorandum is submitted by Plaintiff in opposition to the Motion for Summary Judgment brought by Defendant Affinity Plus Federal Credit Union.

PROCEDURAL BACKGROUND

The Trustee, Charles W. Ries, ("Plaintiff') initiated this adversary action against Rochester Motor Company dba Rochester Ford ("Rochester Ford"), and Affinity Plus Federal Credit Union ("Affinity") alleging a preferential transfer. Affinity has filed a Motion for Summary Judgment with affidavits and a Memorandum of Law. This is Plaintiff's

Memorandum of Law in Opposition to Summary Judgment and Cross-Motion for Summary Judgment.

DOCUMENTS COMPRISING THE RECORD

1. Affidavit of Charles W. Ries
    a. Purchase Agreement for the Ford Escort

STATEMENT OF THE FACTS

On February 4, 2002, Debtor Matthew Higgins, together with Randy Higgins, purchased a 2001 Mazda 626 ("Mazda"). The Mazda was financed through Affinity.

On August 4, 2004, the Debtors purchased a 2003 Ford Escort ("Escort") from Defendant Rochester Ford for a total purchase price of $11,998 plus taxes, fees and a service contract for a total of $13,642.37. The Debtors also traded in the Mazda on the Escort. The Debtors received $7,250.00 in trade value for the Mazda. The Debtors' outstanding obligation to Affinity owed on the Mazda was $16,669.00. After the $7250.00 (value of trade-in) and a $4,000.00 payment (cash supplied by Debtors) were applied to the obligation to Affinity, Rochester Ford assumed the remaining obligation owed to Affinity of $5,419.00 and added that amount to the purchase price of the Escort. The total obligation owed to Rochester Ford was then $19,061.37, which is the amount the Debtors financed.

Defendant Affinity received the payment of $16,669.00 and released its lien on the Mazda. The Debtor filed bankruptcy approximately three weeks later. The Trustee initiated the above-captioned adversary action to recover the $4,000.00 paid to Rochester Ford that was used to partially satisfy the debt owed to Affinity.

ARGUMENT

A motion for summary judgment should be granted when "there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law." Fed. R. Civ.

P. 56(c);[1] Lujan v. National Wildlife Fed'n, 497 U.S. 871, 884 (1990); and Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986). The court must not determine the weight and the truth of the matter, but only whether there is a genuine issue for trial. Johnson v. Enron Corp., 906 F.2d 1234, 1237 (8th Cir. 1990). The court must view any factual inferences in favor of the non-moving party. Lujan v. National Wildlife Fed'n, 497 U.S. at 888. The moving party must present significant, probative, and substantial evidence linked to the elements of its claims. In re Mathews, 207 B.R. 631, 635 (Bankr. D. Minn. 1997).

The party moving for summary judgment has the burden of showing that the record fails to establish a genuine dispute on a material fact. Celotex Corp. v. Catrett, 477 U.S. at 323. The moving party may do this by merely pointing out the absence of evidence to support the non-moving party's cause. Augustine v. Gaf Corp., 971 F.2d 129, 132 (8th Cir. 1992). If this is met, the burden shifts to the non-moving party to set forth affirmative, specific facts demonstrating that a genuine issue exists as to each essential element of that party's case. Lujan v. National Wildlife Fed'n, 497 U.S. at 884. A material fact is one that might affect the outcome of the suit. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986). A genuine issue exists if there is evidence such that a reasonable jury could support the non-moving party's version of the facts. Anderson v. Liberty Lobby, Inc., 477 U.S. at 248. The non-moving party must produce significant, probative, and substantial evidence to demonstrate its version of the facts. In re Mathews, 207 B.R. 631, 635 (Bankr. D. Minn. 1997). If the non-moving party fails to make this showing, the moving party is entitled to summary judgment as a matter of law. Luian v. National Wildlife Fed'n, 497 U.S. at 884.

Rule 56 of the Federal Rules of Civil Procedure applies in adversary proceedings pursuant to Rule 7056 of the Federal Rules of Bankruptcy Procedure.

I. **The $4,000.00 in cash that was paid by Debtors to Rochester Ford was paid for the benefit of Affinity and it constitutes a preference.**

Affinity received $16,669.00 payment on a loan secured by a vehicle that was only worth $7,250.00.[2] In its Motion for Summary Judgment, Affinity argues the Mazda was worth $9,500.00. It does not matter which value is used; the analysis does not change.

The crux of the Trustee's claim is that the Debtors paid $4,000 on a debt that was under secured by $9,419. Using Affinity's argument, Rochester Ford, in allowing $7,250 for trade-in, essentially took advantage of the Debtors to the extent of $2,250. The Trustee doubts that that was in fact the case, but even assuming for purposes of the Summary Judgment Motion, that $9,500 was the actual fair market value of the vehicle, Affinity was still under secured by $7,169. Whichever is the correct amount of the shortfall, it is undisputed that the Debtors paid $4,000 of that amount. The Trustee's preference claim then is that the $4,000 paid on the under secured debt constitutes a preference. The Trustee is not now, nor ever has, alleged that he has the right to recover the amount of the Affinity debt essentially assumed by Rochester Ford but rather is only making a claim for the amount of the unsecured debt that was paid by the Debtors less than a month before the filing.

Section 547(b) of the United States Code provides the trustee may avoid any transfer of an interest of the debtor in property –

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

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

(3) made while the debtor was insolvent;

(4) made on or within 90 days before the date of the filing of the petition;

[2] For purposes of this motion, the Trustee does not dispute Affinity Plus's value of $9,500 for the Mazda.

(5) which enables the Defendants to receive more than it would have received pursuant to a distribution under Chapter 7 if the transfer had not been made and Defendants would have received payment to the extent provided for by Title 11 of the Bankruptcy Code.

When the undisputed facts are analyzed under the elements of a preference, it is clear the $4,000.00 paid to Rochester Ford by the Debtors is indeed a preference.

a. To of for the benefit of a creditor

The $4,000.00 was paid to Rochester Ford, however it was applied towards the debt owed to Affinity to reduce the amount of the debt. The purchase agreement, in fact, shows that of the total debt of $16,669.00, $4,000 was paid by the Debtors and the difference of $12,669.00 constituted the negative down payment. The payment was made to Rochester Ford and for the benefit of Affinity. (See Purchase Agreement — Attached as Exhibit #1 to Affidavit of Charles W. Ries.)

b. For or on account of an antecedent debt owed by the Debtor before such transfer was made

There is no dispute that the obligation owed to Affinity arose before the Debtors paid $4,000.00 to Rochester Ford to be applied to the Affinity debt.

c. Made while the Debtor was insolvent

Defendant Affinity appears to be arguing the Debtors' liquidity in its Memorandum of Law. Affinity goes to great length both in its Discovery and in its Memorandum asserting that for some reason the Debtors' income and expenses has some bearing on the Trustee's ability to recover the preference and that the Trustee for some reason has a duty to establish that the Debtors had negative cash flow. Insolvency, however, is a determination that the Debtors' debts are greater than all of their non-exempt assets.

11 U.S.C.§ 101 (32) defines "insolvent" in the case of an individual. Insolvent means that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation exclusive of property that my be exempted from property of the estate under Section 522 of the Bankruptcy code under 11 U.S.C. § 101 (32). Further, under 11 U.S.C. § 547 (0, a debtor is presumed insolvent on and during the 90 days before the filing of the bankruptcy.

"[A] presumption imposes on the party against whom it is directed the burden of going forward with evidence to rebut or meet the presumption, but does not shift to such party the burden of proof in the sense of the risk of nonpersuasion...." Fed.R.Evid. 301.

The Trustee is entitled to rest on the presumption until evidence is presented that meets or rebuts the presumption. Matter of Emerald Oil Co., 695 F.2d 833, 838 (5th Cir. 1983). As additional evidence, however, of insolvency, the Trustee would point out that the Debtors' bankruptcy schedules schedule assets of $135,525.00 of which $32,800 were claimed as exempt and the Debtors have scheduled liabilities of $151,100.00. Based both upon the presumption and the Debtors' schedules, which were verified and filed with the Court, Defendant Affinity has not provided any evidence to rebut the presumption of insolvency.

d. Made on or within 90 days before the date of the filing of the petition

There is no dispute the $4,000.00 was paid to Rochester Ford less than a month prior to the bankruptcy filing and then paid to Affinity less than 3 weeks before the filing so under any analysis the transfer is well within the 90 days prior to the date of the filing of the petition.

e. Which enables the Defendants to receive more than it would have received pursuant to a distribution under Chapter 7 if the transfer had not been made and Defendants would have received payment to the extent provided for by Title 11 of the Bankruptcy Code.

Determination of whether a particular transfer is preferential is to be determined not based upon what would have happened if the Debtors' assets had been liquidated and distributed at the time of the alleged preferential payment, but rather the actual effect of the payment is

determined by bankruptcy results. Palmer Clay Products Co. v Brown, 297 U.S. 227, 229, 56 Sup. Ct. 450, 451 (1936); see also *In re*Tenna Corp., 801 F.2d 819, 829 (5th Cir. 1986). This is different than the other elements of a preference which are determined at the time the transfer is made.

A creditor is charged with the value of what was transferred plus any additional amount which creditor would be entitled to receive in a Chapter 7 liquidation. As long as the distribution in bankruptcy is less than 100 percent, any payment on account of an unsecured creditor during the preference period will enable the creditor to receive more than he would have received had the payment not been made *In re*Lewis W. Shurtleff, Inc., 778 F.2d 1416 (9th Cir. 1985).

Additionally, the Courts have found that even though there may be a collateral source for payment in the event of a debtor's default, that has no bearing on whether a payment is preferential. Rather, the relevant inquiry is not whether a creditor may have recovered all of the monies owed by the debtor from any source whatsoever, but instead whether the creditor would have received less than 100 percent payout from the debtor's estate. See 5 Colliers on Bankruptcy (Matthew Bender), ¶ 547.03 (7) (15th Ed. 1990); *In re*Powerine Oil Co., 59 F.3d 969, 973 (9th Cir. 1995).

II. The earmarking defense does not apply to the $4,000.00 cash paid by Debtors at the time of the transaction because it resulted in a diminution of the estate.

The earmarking doctrine applies when a debtor has agreed to use a creditor's advance of funds to pay a specified preexisting debt. Nation-Wide Exchange Services, Inc., 2003, 291 B.R. 131, 146. The parties must perform the agreement within the applicable period set forth under § 547(b)(4). Id. The transaction as a whole must not result in a diminution of the estate. Id. The earmarking doctrine typically involves three subjects: (1) the new creditor; (2) the old creditor; and, (3) the debtor. Bohlen Enterprises, LTD. v. Nat'l Bank of Waterloo, 859 F.2d 561 (8th Cir. 1988), *rehearing and rehearing en banc denied,* (Feb. 17th, 1989).

The transaction at bar involves a diminution of the estate. The Debtors paid $4,000 for the benefit of Affinity at the time of the Escort transaction and Rochester Ford then paid the balance. A review of the purchase agreement attached to Affinity's Motion shows in fact that the amount of debt assumed in the agreement by Rochester Ford was the balance of $16,669.00 reduced by the $4,000 paid by the Debtors. Affinity argues the transaction falls within the parameters of the earmarking doctrine. Rochester Ford sold a vehicle to Debtors for $13,642.37. It then satisfied the obligation owed to Affinity by crediting the Debtors $7,250 for the trade-in of the Mazda and $4,000 received from the Debtors and then paid the balance owed on the Escort debt. It then paid $16,669.00 to Affinity.

In summary then, the $16,669.00 was paid as follows:

Mazda trade-in	$7,250
Cash paid by Debtors	$4,000
Debt assumed by Rochester Ford	$5,419
TOTAL:	$16,669

Again, even if the Court were to agree with Affinity's argument that the Mazda was worth $9,500, the only difference would be that the debt would have been under secured by $7,169 rather than $9,419. The earmarking doctrine applies to the debt actually assumed by Rochester Ford; it does not apply to the portion of the debt that was paid for by the Debtors.

III. **The Trustee has** the right **to recover the preference** from Affinity **and** Rochester Ford.

11 U.S.C. 550 (a) provides "except as otherwise provided for in this section to the extent that a transfer is avoided under Section 544, 545, 547, 548, 549, 553 (b) or 724 (a) of this title, the Trustee can recover for the benefit of the estate the property transferred, or, if the Court so orders, the value of such property from (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made ..."

Here the payment itself was actually made to Rochester Ford. Nevertheless, the party for whose benefit the transfer was made was clearly Affinity. Since it allowed Affinity to be paid the entire amount of the debt where otherwise there would have been a substantial deficiency (whether $7,169 or $9,419), the Trustee has the right to recover from either of the defendants. The Trustee, however, is entitled to only one recovery. See 11 U.S.C. § 550 (d). Again, the Trustee is not attempting to recover that portion of the debt which was simply assumed by Rochester Ford, but only the portion of the debt which was actually paid by the Debtors.

CONCLUSION

The Trustee believes that there are no genuine issues of material facts in dispute and that Summary Judgment is appropriate. The Debtors paid $4,000 which was used to reduce the unsecured portion of Affinity's claim. The Trustee is not attempting to collect the debt which was not paid by the Debtors, and is essentially giving Affinity the benefit of the earmarking defense to the extent the earmarking defense applies. The Trustee believes there are no factual circumstances which would be a defense to the Trustee recovering the $4,000 which the Debtors paid for the benefit of Affinity and the Court should grant Summary Judgment in favor of the Trustee.

Dated: September 8, 2004.

/e/Charles W. Ries

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