(Cite as: 1988 WL 79196 (Bankr.D.Vt.))

In re William A. RUSSELL, Jr., Debtor.

Timothy J. WELLS, Trustee, Plaintiff,

v.

DELOCONDA PROPERTIES, Defendant.

Bankruptcy No. 87-30.

Adv. No. 87-51.

United States Bankruptcy Court, D. Vermont.

April 19, 1988.

P.A. Pearlman, Skeen & Pearlman, P.C., Denver, Colo., for Deloconda Properties (Deloconda).

T.J. Wells, White River Junction, Vt., Trustee.

MEMORANDUM DECISION ON DEFENDANT'S SUMMARY JUDGMENT MOTION TO DISMISS PREFERENCE ACTION

FRANCIS G. CONRAD, Bankruptcy Judge.

***1** The trustee seeks recovery of monies paid under a conditional assignment of rents and leases as voidable preferences under 11 USC § 547(e)(3). Because we find that Deloconda is secured and the trustee has failed to carry his burden of proof we grant the motion for summary judgment.

This adversary proceeding commenced on October 9, 1987 with the filing of the trustee's complaint for preference and turnover. [FN1] Deloconda answered and moved for summary judgment. The parties stipulated to the relevant facts.

> FN1. We have jurisdiction to hear this adversary proceeding under 28 USC § 1334(b) and the Reference Order to this Court. This is a core matter under 28 USC § 157(b)(2)

(F). This Memorandum Decision constitutes findings of fact and conclusions of law under F.R.Civ.P. 52 as made applicable by Rules of Practice and Procedure in Bankruptcy Rule 7052.

On October 15, 1985, Deloconda conveyed its interest in commercial real property located at 1845 Federal Boulevard, Denver, Colorado to William A. Russell, Jr., Debtor.

The purchase price for the property was $575,000, which sum was satisfied by the debtor's assumption of a first lien on the property held by Western National Bank (WNB) together with cash and a promissory note to Deloconda. Debtor's promissory note was secured by a Deed of Trust and Conditional Assignment of Rents.

On October 18, 1985, the Deed of Trust and the Assignment of Rents was recorded in the real property records of the Clerk and Recorder of the City and County of Denver, at Reception Nos. 080642 and 080643.

Subsequently, Debtor leased the property to Generator City, a company in which he then held a controlling interest.

Debtor's promissory note obligated him to make monthly payments to Deloconda in the amount of $2,431.80, and, under the terms of WNB's lien assumption, monthly payments to WNB in the amount of $2,618.91.

Debtor made monthly payments to both Deloconda and WNB from October, 1985 until November, 1986. In November, 1986, Debtor advised Deloconda that he had moved to Vermont. Debtor did not make the November and December, 1986 payments to Deloconda and WNB.

The debtor filed his petition for relief in bankruptcy under Chapter 7 of Title 11, U.S.Code, on February 11, 1987.

Deloconda took possession of the property on or about December 2, 1986 and issued a Notice (presumably to the tenants) of Assumption of Possession and Exercise of Authority to Collect Rents. Deloconda then proceeded to collect the following rents from Generator City:

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01/02/87 $2,400
05/06/87 $2,600
06/18/87 $2,600
08/02/87 $2,600
09/02/87 $2,600
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With Deloconda's permission and at Deloconda's direction, Generator City paid directly to WNB: 03/14/87--$2,000; 03/20/87--$2,000; and 04/18/87--$2,000. All sums received by Deloconda were paid to WNB.

Deloconda advanced its own funds to keep WNB's cash debt current. Also, in May, 1987, Deloconda paid $4,800 to the Treasurer of the City and County of Denver to redeem the real property from a 1985 tax sale.

The trustee contends that the $2,400 collected by Deloconda from Generator City on January 2, 1987, under the assignment of rents, was a preferential transfer, voidable under 11 USC § 547(b), because the assignment of rents could not be perfected until Deloconda took some affirmative action such as taking physical possession of the property. As further support for his action, the trustee contends that a judgment lien creditor could have levied on the rents prior to the required affirmative action, and thus Deloconda's lien is inchoate.

***2** Deloconda says that the "transfer" complained of took place before the preference period when it recorded the assignment of rents. As support for its position Deleconda asserts that under Colorado law an assignment of rents from real property is an interest in real property and that the interest is perfected against subsequent purchasers upon recordation of the assignment. Deloconda also notes that it received no more than it would receive in liquidation had the payment not been made.

The trustee also claims that rents collected by Deloconda after the petition but prior to any relief from stay are property of the estate under 11 USC § 549. Deloconda insists that taking possession of the property to enforce the assignment of rents did not constitute a separate transfer of property of the estate. As an alternative argument, Deloconda asserts that the rents were "cash collateral" and could not be used by the trustee unless the trustee gave Deloconda adequate protection, which he did not do.

Two issues need to be decided by us: 1) is the $2,400 January, 1987 rent payment to Deloconda a preference under 11 USC § 547(b), and, (2) are the post-petition payments to Deloconda voidable under 11 USC § 549?

Section 547 may undo pre-bankruptcy transfers if certain creditors are given "preferential" treatment. The trustee has the initial burden of proof and must show that the elements of a preferential transfer have taken place. 11 USC § 547(b) provides:

(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of

an interest of the debtor in property--

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

(2) for or on account of an antecedent debt owned 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; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; 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.

Once the § 547(b) elements are proven the burden of proof shifts to the creditor. The typical creditor will attempt to show it received no more than it would have received in a Chapter 7 liquidation if the transfer had not been made.

As a general principal, payments to a fully secured creditor are not preferential. Herzog and King, 4 Collier Bankruptcy Practice Guide, 64.07(6)(b) (1988). See also, 4 Collier on Bankruptcy 547.08 (15th Ed.1987). This is because the preference payment only reduces the secured creditor's claim in the bankruptcy proceedings.

***3** The principal that payments to a fully secured creditor are not preferences is supported by case history. For example, see, Gilbert v. Gem City Savings Association (In re Hale), 15 BR 565 Bkrtcy.S.D.Ohio 1981). See also, Mazer v. Aetna Finance Company (In re Zuni), 6 BR 449 (Bkrtcy.D.N.M.1980) (the payment of a secured claim is not a preference if of equivalent value to the estate.)

Property rights are determined by State law, Butner v. United States, 440 US 48, 58 L.Ed.2d

136, 99 S.Ct. 914. The rights of a mortgagee/assignee have been addressed by the Colorado Supreme Court in Meggenson v. Hall, 111 Colo. 104, 137 P.2d 411 (1943).

Under our statute, and the general law as announced both prior, and subsequent, to the enactment of the statute, a mortgagee, even though rents are pledged as security, until he takes some effectual steps to subject them to the payment of is (sic) debt, has but an inchoate or passive lien on such rentals.

Meggenson, id., at 413.

In Meggenson, id., the Colorado Supreme Court did not elaborate on what steps would be "effective" to subject rents to the payment of a debt, but in a case earlier to Meggenson, Fisher v. Norman Apartments, 101 Colo. 173, 72 P.2d 1092 (1937), they gave approval to the appointment of a receiver and physical possession, Fisher, id., at 1092, as steps necessary to prevent divestment by another judgment lien creditor. In this proceeding, Deloconda took possession and gave notice of its rights. Thus, we find that Deloconda perfected its interest in the rents on or about December 2, 1986, a time less than ninety (90) days before the debtor filed his bankruptcy petition. As such, the $2,400 collected on January 2, 1987 is a preference under 11 USC § 547 unless the trustee fails to show Deloconda received more than it would have received in Chapter 7 if the transfer had not been made. 11 USC § 547(b)(5). The trustee has the burden on this issue, 11 USC § 547(9), and on the facts of this case has failed to carry his burden. No evidence was presented by the trustee to show Deloconda received more than it would have received under Chapter 7. We hold, therefore, that the $2,400 collected on January 2, 1987 was not a preference under 11 USC § 547(b).

The trustee has also asked that Deloconda regorge all the rents it collected post-petition as voidable transfers under 11 USC § 549(a). For cause, the trustee asserts that Deloconda, to preserve its priority in future rents, should have filed a notice under 11 USC § 546(b) and that the filing of an adversarial complaint should not satisfy such notice. We don't believe the trustee's argument has merit. As we said earlier, Deloconda is a secured creditor under Colorado State law. As such, its rights are not subject to divestment by levy of a judgment creditor. Thus, no notice of its interest to the trustee was required.

Although this proceeding is similar to cases relied on by Deloconda, it is even stronger than the facts in In re Colter, Inc., 46 BR 510 (Bkrtcy.D.Colo.1984), aff'd, 47 BR 1008 (D. Colo.1985). There, the secured creditor filed its § 546(b) notice because it was barred from taking any other action by § 362. The Court found the creditor to be unsecured pre- petition, but secured after it filed its notice. Here, Deloconda took possession pre-petition based on a clearly written contract of assignment which was recorded in the land records. No further notice was required to be sent to anyone. The trustee took the property subject to Deloconda's interest.

***4** Accordingly, we find that the post-petition rentals were proceeds within the meaning of § 363(a) and should have been sequestered for Deloconda's benefit. An appropriate Order will be entered.

ORDER ON TRUSTEE'S MOTION FOR SUMMARY JUDGMENT TO DISMISS PREFERENCE ACTION

The Court, having this day entered its Memorandum Decision on the above referenced adversary proceeding, Now, ORDERS:

1) That Deloconda's motion for summary judgment is GRANTED in all respects;

2) That JUDGMENT FOR DELOCONDA be entered by the Clerk of the Bankruptcy Court; and

3) That Adversary Proceeding No. 87-0051 be and hereby is Ordered CLOSED, pending the 10 day appeal period.

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