

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MISSOURI
ST. JOSEPH DIVISION**

In re:)	
)	
TIMOTHY D. PRINDLE,)	Case No. 01-50184-JWV
)	
Debtor.)	
)	
BRUCE E. STRAUSS, TRUSTEE,)	
)	
Plaintiff,)	
)	
v.)	Adversary No. 01-5013-JWV
)	
CHRYSLER FINANCIAL COMPANY,)	
L.L.C.,)	
)	
Defendant.)	

MEMORANDUM OPINION AND ORDER

The issue before the Court in this Adversary Proceeding is a somewhat unusual one: Whether a secured creditor's acceptance of a motor vehicle as substitute collateral on an earlier note and security agreement, without timely perfection of its lien as required by the Bankruptcy Code, is a voidable preference under 11 U.S.C. § 547(b).

Bruce E. Strauss, the trustee ("Trustee") in the underlying Chapter 7 case, filed a Complaint against Chrysler Financial Company, LLC ("Chrysler") seeking to void Chrysler's purported lien on the Debtor, Timothy D. Prindle's ("Debtor") 2001 Dodge pickup and seeking a declaration that the Debtor's granting of the lien was a preferential transfer. Chrysler responded by asserting that its properly perfected security interest in the Debtor's 2000 Dodge Dakota pickup transferred to the 2001 vehicle, thereby negating the necessity of resubmitting a notice of lien within the 20-day period required by 11 U.S.C. § 547(c)(3)(B).

The parties stipulated to the facts and submitted the matter to the Court without further evidence. The Court has reviewed the pleadings and the stipulated facts and the parties' trial briefs, has conducted its own independent research, and is now ready to rule.¹ For the reasons set out below, the Court finds that Chrysler's purported lien in the 2001 vehicle was preferential and must be declared null and void.

This Court has jurisdiction over this Adversary Proceeding pursuant to 28 U.S.C. § § 157 and 1334 and 11 U.S.C. § 547. This is a core proceeding under 28 U.S.C. § 157(b)(2)(F).

FACTUAL BACKGROUND

The parties have stipulated to and the Court finds the following facts:

1. On November 8, 2000, Debtor entered into a Retail Installment Contract with Sut Hill Trenton for the purchase of a 2000 Dodge Dakota. The purchase price for the vehicle was \$24,900.00, and after credit for equity in his trade-in and the addition of service contract, Debtor agreed to finance the amount of \$24,299.00 with Chrysler. The term of the contract was 60 months; the interest rate was .9%, and Debtor's monthly payments of \$414.48 were to begin on December 23, 2000.

2. Chrysler bought the Retail Installment Contract from the dealer on November 14, 2000.

3. On November 17, 2000, the Notice of Lien form sent by the dealer was received stamped by the Missouri Department of Revenue, Motor Vehicle Bureau.

4. On November 17, 2000, Chrysler was contacted by a representative of the dealer, who stated that the 2000 Dodge Dakota had been declared a total wreck and that Debtor was requesting a substitution of collateral for the Retail Installment Contract.

5. On November 20, 2000, Chrysler faxed a Substitution of Collateral form to the dealer to be completed and executed by Debtor. The cover letter instructed the dealer to return the bill of sale, Notice of Lien, insurance verification, and the signed Substitution of Collateral form.

¹ This Memorandum Opinion and Order constitutes the Court's findings of fact and conclusions of law as required by Rule 7052, Fed.R.Bank.P.

6. Debtor's insurer, American Family Insurance Company, valued the Dakota at \$22,000.00 and agreed to pay \$21,500.00 after accounting for Debtor's \$500.00 deductible amount. Chrysler agreed to release its lien on the Dakota for payment of \$21,500.00.

7. On December 15, 2000, Chrysler received from the dealer the executed Substitution of Collateral form, an original MADA Form 4809 Notice of Lien, and a copy of the Manufacturer's Certificate of Origin on the substituted vehicle, a 2001 Dodge 1500 Pickup. The documents showed the selling price for the Dodge Pickup was \$21,500.00, plus delivery fees and a service contract, for a total of \$23,348.95.

8. Debtor took delivery of the 2001 Dodge 1500 Pickup on December 15, 2000.

9. Debtor paid no extra consideration for the substituted vehicle.

10. On January 12, 2001, Debtor submitted an application for title to the Dodge 1500 Pickup, which noted the lien of Chrysler.

11. On March 2, 2001, Debtor filed his Chapter 7 case in the Western District of Missouri. This filing occurred 49 days after the title application was submitted by Debtor on the Dodge 1500 Pickup, and 89 days after Chrysler's lien on the Dodge Dakota was perfected.

12. The insurance proceeds of \$21,500.00 from the totaled Dodge Dakota were paid to the dealer for the new vehicle rather than paying off the loan to Chrysler on the Dodge Dakota.

DISCUSSION

Section 547(b) of the Bankruptcy Code² allows a trustee to avoid a payment or other transfer of a property interest of a debtor to a creditor upon a showing that the transfer was:

- (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 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;

² Title 11, United States Code.

- (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.

11 U.S.C. § 547(b).

The Trustee argues that he has established every element of a preference and therefore the lien must be avoided as preferential. The Court agrees. Clearly, the granting and perfection of the security interest in the 2001 vehicle was for Chrysler's benefit, was on account of an antecedent debt (the November 8, 2000, retail installment contract), was made while the Debtor was presumptively insolvent pursuant to 11 U.S.C. § 547(e)(3)(F), was made within 90 days of the Debtor's bankruptcy filing, and would allow Chrysler to receive more than it would otherwise receive in a Chapter 7 case if the transfer had not been made.

The Trustee further contends that Chrysler is not entitled to the protections of § 547(c)(3)³ because Chrysler did not perfect its security interest in the 2001 vehicle until January 12, 2001, which was 28 days after the Debtor had taken possession of the vehicle on December 15, 2000.

Chrysler counters that the 2001 vehicle was merely substituted as collateral on the earlier note and security agreement for the 2000 Dodge Dakota, which had been totally demolished in an accident, and that the transaction is therefore protected by the earmarking doctrine as enunciated by the Eighth Circuit Court of Appeals in *Kaler v. Community First Nat'l Bank (In re Heitkamp)*, 137 F.3d 1087 (8th Cir. 1998), ("*Heitkamp*") subsequently followed by the Eighth

³ Section 547(c)(3) provides that a trustee cannot avoid a transfer

- (3) that creates a security interest in property acquired by the debtor-
 - (A) to the extent such security interest secures new value that was-
 - (i) given at or after the signing of a security agreement that contains a description of such property as collateral;
 - (ii) given by or on behalf of the secured party under such agreement;
 - (iii) given to enable the debtor to acquire such property; and
 - (iv) in fact used by the debtor to acquire such property; and
 - (B) that is perfected on or before 20 days after the debtor receives possession of such property;

Circuit Bankruptcy Appellate Panel in *Krigel v. Sterling National Bank (In re Ward)*, 230 B.R. 115 (BAP 8th Cir. 1999) (“*Ward*”).

Chrysler’s reliance on the earmarking doctrine is misplaced. The earmarking doctrine is a judicially created exception to § 547 that derives from the statutory requirement that a transfer, in order to be deemed preferential, must be “of an interest of the debtor in property.” *Buckley v. Jeld-Wen, Inc. (In re Interior Wood Products Co.)*, 986 F.2d 228, 231 (8th Cir. 1993); *Stingley v. AlliedSignal, Inc. (In re Libby International, Inc.)*, 240 B.R. 375, 377 (Bankr. W.D. Mo. 1999). The Bankruptcy Appellate Panel in *Ward* succinctly summarized the doctrine:

“According to the earmarking doctrine, there is no avoidable transfer of the debtor’s property interest when a new lender and a debtor agree to use loaned funds to pay a specified antecedent debt, the agreement’s terms are actually performed, and the transaction viewed as a whole does not diminish the debtor’s estate. No avoidable transfer is made because the loaned funds never become part of the debtor’s property. Instead, a new creditor merely steps into the shoes of an old creditor.” *Ward*, 230 B.R. at 118.

First, the earmarking doctrine does not fit in this case because there is no new lender making a loan to pay a specified antecedent debt. In fact, there is no new loan being made at all, and there is no antecedent debt that is being paid off. Chrysler simply agreed to accept the 2001 vehicle as new (or substituted, if you prefer) collateral for its old loan.

Second, contrary to Chrysler’s argument, the transaction, viewed as a whole, *does* diminish the Debtor’s estate. After the 2000 Dodge Dakota was wrecked on November 17, 2000, Chrysler released its lien on that vehicle in return for the Debtor’s insurer’s payment of \$21,500.00 in insurance proceeds to the Debtor. Then, on December 15, 2000, using the insurance proceeds he had received, the Debtor purchased the 2001 Dodge pickup and signed the necessary documents to give Chrysler a security interest in the 2001 vehicle. However, Chrysler did not perfect its security interest in the new vehicle until January 12, 2001, when it submitted the title application to the Department of Revenue. Because Chrysler’s security interest was not perfected until January 12, 2001, the “transfer” for bankruptcy preference purposes was deemed made on that date. 11 U.S.C. § 547(b)(2)(B). As a result, the transfer was on account of an antecedent debt, *Gregory v. Community Credit Co. (In re Biggers)*, 249 B.R. 873, 877 (Bankr. M.D. Tenn. 2000), and therefore the Debtor’s bankruptcy estate was diminished.

For some strange reason, Chrysler has argued a substitution of collateral theory but has not cited any cases or authority for that proposition. It is generally accepted that a substitution in collateral is a proper defense to a preference action, if it meets the requirements of 11 U.S.C. § 547(c)(1)(A) and (B).⁴ *Eide v. United States of America (In re Quade)*, 108 B.R. 674, 679 (Bankr. N.D. Iowa 1989). “The mere substitution of new security in the place of security for an old debt does not ordinarily create a preference because there is no diminution of the debtor’s estate whereby the creditors may be injured. 4 Collier on Bankruptcy, P 547.22 (15th ed. 1981). It is a different matter, however, when the transaction actually results in a depletion of the debtor’s assets. In such a case, where the new security is of greater value than the old, a voidable preference for the difference in value between the two securities may result.” *Lancaster v. First National Bank of Greeneville (In re Cloyd)*, 23 B.R. 51, 54 (Bankr. E.D. Tenn. 1982). *See also Sawyer v. Turpin*, 91 U.S. 114, 120, 23 L.Ed. 235 (1875) (“It is too well settled to require discussion, that an exchange of securities within the four months (now three months) is not a fraudulent preference with the meaning of the Bankrupt Law, even when the creditor and the debtor know that the latter is insolvent, if the security given up is a valid one when the exchange is made, and if it be of undoubtedly of equal value with the security substituted for it.”).

These cases do not, however, carry the day for Chrysler, either, because, as previously discussed, there has been a diminution of the Debtor’s estate in this case. Chrysler had a properly perfected security interest in the Debtor’s 2000 Dodge Dakota pickup. After that vehicle was demolished in an accident on or about November 17, 2000, Chrysler released its lien in that vehicle so that the Debtor’s insurer would release \$21,500.00 in insurance proceeds to the Debtor to allow him to purchase another vehicle. The Debtor did, in fact, purchase a replacement vehicle, a 2001 Dodge 1500 pickup, on December 15, 2000, but Chrysler did not perfect its lien in the new vehicle until January 12, 2001, some 28 days after the Debtor took possession of the new vehicle.

Under Missouri law, a lien on a motor vehicle is perfected by taking all of the steps necessary for perfection pursuant to Sections 301.600 to 301.660. Rev.Stat.Mo. **Check proper cite** Unless the lien is perfected as required by those statutes, the lien is not valid against

⁴ **Insert here the cited statute...**

subsequent transferees or lienholders of the motor vehicle who took without knowledge of the lien. Section 301.600.1, Rev.Stat.Mo. As a hypothetical lien creditor, the bankruptcy trustee takes without knowledge of the unperfected lien. **Need cite...**

In this case, Chrysler had no collateral for its loan from the time the Debtor wrecked his 2000 Dodge Dakota pickup in November 2000 until the Debtor acquired the 2001 Dodge pickup on December 15, 2000. The 2001 Dodge pickup became property of the Debtor's bankruptcy estate when he subsequently filed his bankruptcy petition on March 2, 2001. Between December 15, 2000, and January 12, 2001, Chrysler had, at best, an unperfected security interest in the new 2001 vehicle. When Chrysler failed to perfect its security interest within the 20 days required by § 547(c)(3), the date of the "transfer" for preference purposes became January 12, 2001, not December 15, 2000, and because the Debtor filed bankruptcy within 90 days thereafter, Chrysler's perfection of its security interest became a voidable preference.

Therefore, it is

ORDERED that the relief sought by the Trustee, Bruce E. Strauss, be and is hereby GRANTED, the lien obtained by Chrysler Financial Company, LLC, in the Debtor's 2001 Dodge 1500 SLT 4 x 4, VIN1B7HF16Y31S153269, is hereby declared to be null and void, and the perfection of the lien by Chrysler Financial Company, LLC, in that vehicle on or about January 12, 2001, is declared to be a preference and is hereby voided. **Rewrite...**

SO ORDERED this _____ day of December, 2001.

/s/ Jerry W. Venters
United States Bankruptcy Judge

A copy of the foregoing mailed electronically or conventionally to:
Bruce E. Strauss
Janet I. Blauvelt