UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

In re

DANIEL P. HUITEMA and
MIRANDA J. HUITEMA,

Debtors.

Case No. 03-33310

Chapter 7

MEMORANDUM DECISION

The debtors filed a chapter 7 petition on September 4, 2003. Included in their schedule of secured creditors was a loan for a recently purchased 2001 Ford F350 pickup truck. During the course of the bankruptcy, the trustee determined that the security interest of WFS Financial might be voidable as a preference, and he filed a complaint against WFS on March 3, 2004. In the meanwhile, debtors' counsel had advised them to continue making payments until such time as the matter was resolved as it would be difficult for them to reinstate the payments if WFS prevailed. On the other hand, debtors' counsel did not recommend that they sign a reaffirmation agreement.

In March 2004, the debtors were advised by WFS that there was no need to make any more payments as WFS was not fighting the trustee's demand. Between the time of the filing of the case and the time they were told to stop making payments, the debtors had paid $3,452.96 to WFS.

The creditor released the vehicle title to the trustee on May 10, 2004, and the adversary proceeding was voluntarily dismissed on May 14, 2004. The trustee ultimately satisfied the estate's lien when the debtors paid the estate slightly less than the amount owed to WFS.

On September 19, 2004, debtors' counsel requested that WFS return the funds paid postpetition. WFS advised that the matter of demanding money back would have to be taken up with the trustee as the payments were property of the estate. The trustee faxed a letter to WFS on September 24, 2004, disclaiming any interest in the payments and stating that since the payments had been made with postpetition earnings that were *not* property of the estate, he had no objection if the monies were paid to the debtors. *See In re Rubia*, 257 B.R. 324 (B.A.P. 10th Cir. 2001) (holding trustee not entitled to recover postpetition payments made to lienholder prior to avoidance). The funds were not returned to the debtors; hence, this " Motion to Compel Reimbursement of Post-Petition Payments and for Sanctions and Attorney's Fees."

The debtors argue they were not aware of the adversary proceeding to set aside the security interest until after it had been filed. The creditor's refusal to return the funds is willful and the debtors request a refund of payments in the amount of $3,452.96, as well as attorney fees of $750 for the letters and drafting of this motion and other associated documents.

WFS argues because the debtors were driving the truck while the lien avoidance action was pending, returning the monies would constitute unjust enrichment.

The first issue that must be addressed is whether this dispute belongs in bankruptcy court. After all, the trustee was satisfied by his avoidance of the lien and payment to the estate, so the outcome would have no effect on the administration of the estate or amounts to be distributed. It is essentially a two-party conflict between the creditor and debtors. Despite the absence of impact on the estate, however, the dispute is an outgrowth of an adversary proceeding involving a preference under 11 U.S.C. § 547. The debtors could not have made this claim unless the trustee had exercised his

rights on behalf of the estate to avoid the lien; thus, the issue is one that arose under Title 11. *See* 28 U.S.C. § 1334(b). Alternatively, it arose in a case under Title 11 because of the debtors' payments to the creditor while the case was pending and before the lien was avoided pursuant to the trustee's adversary proceeding. *Id.* If the case were sent back to state court, the debtors would have to argue that their right to collect from the creditor arose because of an action by a bankruptcy trustee applying powers peculiar to bankruptcy law and not because of any application of state law involving perfection of liens by a creditor. Therefore, because the relief requested by the debtors is ancillary to and derivative of the preference action, this court has jurisdiction. 28 U.S.C. § 1334(b). For the same reason, this is a core proceeding under 28 U.S.C. § 157(b)(2)(F).

Procedurally, of course, the debtors should have filed an adversary proceeding as this is an action to recover money or property. Fed. R. Bankr. P. 7001(1). Neither party pointed this out. However, before this court dismisses the motion and sends the debtors off to file a summons and complaint, or allows the debtors to reopen and intervene in the adversary proceeding commenced by the trustee, a peek at the merits might be in order.

The issue of a party's right to payments made by the debtor during the pendency of a bankruptcy case and before a lien is avoided usually arises in two contexts: (1) the debtor rescinds a reaffirmation agreement, or discovers that the agreement is invalid, and wants a refund of the money paid while the agreement was or was thought to be valid; or (2) the trustee avoids the lien and also attempts to avoid the diminution in value of the lien from the date of the petition to the date of avoidance by demanding payments made during the interim. Neither scenario fits this case. Here, the debtors never reaffirmed, but they want payments made while they thought they had a secured vehicle.

In re Mandrell, 50 B.R. 593 (Bankr. M.D. Tenn. 1985), involved a combination of the scenarios listed above. The debtor reaffirmed a debt to a secured creditor and then sought to rescind it and recover the payments made under the reaffirmation agreement. After the court's approval of the reaffirmation agreement, the chapter 7 trustee avoided the creditor's security interest as a preferential transfer, obtained possession of the car, and sold it. The debtor, now without a car, sought to recover her postpetition payments to the creditor. The court ordered the payments returned and the parties restored to their pre-reaffirmation agreement status on the basis of the mutual, material mistake of fact that the creditor had an enforceable lien against the car. Since the trustee was not a party to the adversary proceeding, no determination was made as to whether the debtor should compensate the estate for use of the car before the trustee recovered it. *See also In re Marletter*, 236 B.R. 281, 284 (Bankr. M.D. Fla. 1999) (debtor was entitled to have seized funds restored to her when reaffirmation agreement was determined invalid, but creditor was not subjected to punitive damages because garnishment took place while creditor believed agreement was valid). Therefore, it appears that the failure of a reaffirmation agreement may result in the debtors recovering payments, at least to some extent, made while the agreement was thought to be enforceable.

Compensation of the creditor for delay in recovery on account of an invalid reaffirmation agreement has been held appropriate in other cases. In *In re McAuliffe*, 180 B.R. 336 (Bankr. D. Me. 1995), the chapter 7 debtor was entitled to recover from the mortgagee payments made under a reaffirmation agreement after the debtor timely rescinded the agreement and received a discharge, which included the mortgage debt. However, the mortgagee was entitled to some compensation from the debtor for continued use of the mortgaged residence during the period pre-rescission. This allows

the creditor to be compensated for the time the agreement was in effect. Other cases have similarly allowed secured creditors to retain payments under a reaffirmation agreement as compensation for use of the collateral. *See e.g.*, *In re Hitt*, 137 B.R. 401 (Bankr. D. Mont. 1992) (under § 105(a), debtor was not entitled to return of payments that he made under reaffirmation agreement which was voidable, but not void, for lack of reaffirmation hearing; payments were tantamount to rent for use of vehicle securing reaffirmed debt); *In re Hama*, 16 B.R. 730 (Bankr. E.D. Va. 1982) (debtor was not entitled to return of funds paid secured creditor after petition filed, notwithstanding that court refused to approve reaffirmation agreement, where monthly payment thereunder was a just and reasonable monthly rental charge for use of subject motor vehicle).

The trustee's right to payments made pursuant to an avoided security interest are not necessarily the same as the debtor's right to payments made before determination of a failed reaffirmation agreement. In *In re Rubia*, 257 B.R. 324 (B.A.P. 10th Cir. 2001), *affd*, No. 01-3020, 2001 WL 1580933 (10th Cir. 2001), the panel found the trustee, upon avoiding a vehicle lien, could not recover from the creditor the postpetition payments voluntarily made by the debtors to the creditor. The panel explained:

> ... the fixing of [the creditor's] lien on the Ranger was avoided; and the fixing of that lien was automatically "preserved for the benefit of the estate." This interest arising under § 551 is, as argued by the Trustee, property of the estate under § 541(a)(4). However, contrary to the Trustee's position, the nature of that interest does not give the Trustee the right to collect [the creditor's] debt from the debtor postpetition. *See In re Closson*, 100 B.R. 345 (Bankr.S.D.Ohio 1989).
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> Rather ... [the creditor] holds an unsecured claim against the debtor's estate for the entire amount of its debt as represented by its Credit Agreement. *See* 11 U.S.C. § 502(h). Only [the creditor], not the Trustee, has the right to collect that debt. *See Closson*, 100 B.R. at 347-48; *see also C & C Co. v. Seattle First Nat'l Bank* (*In re Coal-X Ltd. "76"*), 103 B.R. 276,

> 280 (D.Utah 1986) ("By avoiding and preserving the lien, the trustee simply steps into the [secured creditor's] shoes and succeeds to the [creditor's] rights *with regard to the lien*.") (emphasis added), *aff'd in relevant part and rev'd in part*, 881 F.2d 865, 866 (10th Cir.1989); 5 *Collier on Bankruptcy* ¶ 551.02[1] (Lawrence P. King ed., 15th ed. rev. 2000) (preservation is of lien only, not other rights held by the creditor). The avoidance of the fixing of its lien merely means that [the creditor] may no longer look to the Ranger to satisfy the debt.

Rubia, 257 B.R. at 327 (citations omitted). From the collateral securing the lien, the trustee could recover the amount of the creditor's claim as of the day the debtor filed for bankruptcy, or the value of the collateral on that day, whichever was less. *Id*. at 328-29. Only the lien became property of the estate; the creditor had no liability to pay anything to the trustee, absent an agreement by the debtor to pay the postpetition payments to the trustee. *Id*. at 329. This decision was affirmed (unpublished) by the Ninth Circuit.

The dissent in *Rubia* pointed out that by disabling the trustee from collecting payments on the obligation underlying the lien, the estate is effectively stripped of any ability to liquidate its lien. Arguing that the payments are indeed "proceeds" of the preserved lien (now property of the estate) and that the lien and the underlying obligation are "inextricably intertwined," the dissent concludes that the postpetition payments made by the debtor to the lender are indeed property of the estate. *Id.* at 330. This would mean that to the extent that the debtor's payments reduce the lien between the date of filing and the date the lien is avoided, the estate should be able to recover those payments from the creditor. In the case of cars, the estate could recover the full value of the car at the time of avoidance, plus payments made on it, which is probably not the same as the value of the car, which tend not to depreciate at the same rate as payments are made. The majority's position solves this problem by giving the trustee the lien as of the date of filing, and any post-petition payments merely reduce the

creditor's unsecured claim in the estate. *Id.* at 327-28. The *Rubia* majority takes no position on whether the *debtor* can recover post-petition payments to the creditor on a discharged debt, the very issue addressed in the instant case.

Little analysis is given in the above cases to whether the trustee's lien interest becomes property of the estate at the date of filing or at some later date, after it has been avoided and possibly reduced by payments made by the debtor. It seems to be assumed that the lien is valued as of the date of petition, and this is what the trustee recovers for the estate. However, § 547(b) states that "the trustee may avoid" a transfer; it does not say that a previously transferred interest is "void." In other words, if the trustee does nothing, the transfer is still effective, which means the transfer is good until a court finds or the parties agree to the contrary. Then, when the avoidance occurs, it is at some date after the filing of the petition. To solve the dilemma of when to value the trustee's interest, it is necessary to return to § 541(a), which states that "[T]he commencement of a case . . . creates an estate. Such estate is comprised of all the following property. . .: (4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section . . . 551 of this title." 11 U.S.C. § 541(a). Accordingly, once the lien is avoided and preserved for the estate, the trustee acquires only the lien, valued as of the date of filing, unadorned by any in personam right to recover money from the creditor.[1]

Since the trustee has no in personam rights to recover from the creditor, the debtor cannot derive any similar rights from the trustee. Consequently, the debtors, if they are to recover, must have

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[1]Valuing the estate's interest at some time after filing could lead to manipulation that might reduce the interest the estate recovers. Suppose Debtor's Mom, a shrewd and prosperous bankruptcy lawyer, pays off the creditor before judgment avoiding the lien is entered. The trustee avoids a lien that now secures no debt. Fortunately, this situation is not before this court.

rights that arise independently of the trustee's avoidance powers. This brings the court back to the only analogous situation raised by the parties and the one that makes sense to the court: a failed reaffirmation agreement. When the debtor made payments, and the creditor accepted them, both parties thought there was a valid security interest.[2] However, the security interest is found to be avoided as of the date of filing the petition. Reaffirmation cases, grounded in a mutual mistake of a material fact, i.e., a valid secured debt, return the parties to their status pre-agreement. The postpetition payments must be returned to the debtors.

In *In re Mandrell*, 50 B.R. 595 (Bankr. M.D. Tenn. 1985), the court ordered the creditor to return postpetition payments to the debtor when the trustee set aside the lien perfection. Both parties had assumed the reaffirmation agreement was valid, but this turned out to be a mutual mistake of a material fact. The court noted that the debtor had driven the car for the period before the lien was avoided, and this might mean that the lien was worth less than it was on the date of filing because the car was worth less. The court indicated that the debtor might owe the *estate* something to compensate for the diminution in value of the lien, but the trustee was not a party so no such order was made. *Mandrell*, 50 B.R. at 596 n.7. This result is consistent with a finding that the lien is valued as of the date of filing as the payments were made by mistake on what was later found to be a discharged, unsecured debt. In the present case the trustee has indicated he does not wish to pursue compensation on behalf of the estate, and he consents to the return of postpetition payments to the debtors.

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[2]The debtors are not without a remedy if the creditor deliberately violated the discharge injunction in enforcing the agreement. *See Cox v. Zale Delaware, Inc.*, 239 F.3d 910 (7th Cir. 2001). *See also In re Marletter*, 236 B.R. 281 (Bankr. M.D. Fla. 1999) (creditor had to return seized funds).

Some courts have held it appropriate to charge the debtor for the use of the collateral before a reaffirmation agreement was rescinded or held invalid. *See In re McAuliffe*, 180 B.R. 336 (Bankr. D. Me. 1995); *In re Hitt*, 137 B.R. 401 (Bankr. D. Mont. 1992); *In re Hama*, 16 B.R. 730 (Bankr. E.D. Va. 1982). However, these cases involved only a dispute between the debtor and creditor over a valid security interest; no lien was avoided for the benefit of the estate. In each case the creditor received payments before invalidity was determined, and the courts recognized that the existence of the agreement had delayed the creditor's right to recover its collateral. Here, the creditor was not delayed in realizing on its collateral because the lien was avoided effective the date of filing. It had no right to recover the collateral. Therefore, there is no reason to compensate the creditor. On the other hand, the creditor's position is not frivolous, and there is no reason to award the debtor attorney fees.

As was stated earlier, this proceeding was styled as a motion, not as an adversary proceeding to recover money or property, which is what it is. Fed. R. Bankr. P. 7001(1). While this court has little patience for form over substance, entering a money judgment is not an option, notwithstanding the movant's correctness on the merits. Therefore, the motion is dismissed, but the debtors shall have 30 days to file an adversary proceeding addressing the same subject matter.

A separate order will be entered.

Dated: March 29, 2005

BY THE COURT:

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Honorable Margaret Dee McGarity
Chief United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

In re

DANIEL P. HUITEMA and
MIRANDA J. HUITEMA,

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Case No. 03-33310

Chapter 7

ORDER DISMISSING DEBTORS' MOTION TO COMPEL REIMBURSEMENT OF POST-PETITION PAYMENTS AND FOR SANCTIONS AND ATTORNEY'S FEES

For the reasons stated in the court's memorandum decision entered on this date,

IT IS ORDERED the debtor's motion to compel reimbursement of post-petition payments and for sanctions and attorney's fees is denied.

IT IS FURTHER ORDERED the debtors shall have 30 days to file an adversary proceeding addressing the same subject matter.

Dated: March 29, 2005

BY THE COURT:

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Honorable Margaret Dee McGarity
Chief United States Bankruptcy Judge

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