UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

In re

Case No. 97-27648

TAMERA RICH,

Chapter 7

Debtor.

TODD ESSER, TRUSTEE,

Plaintiff,

v.

Adversary No. 99-2131

ARCADIA FINANCIAL, LTD.

Defendant.

MEMORANDUM DECISION ON PLAINTIFF'S MOTION
FOR SUMMARY JUDGMENT

The chapter 7 trustee filed this adversary proceeding, seeking to avoid the transfer of a lien on a 1994 Isuzu Trooper from the debtor to Arcadia Financial, Ltd. The trustee also sought turnover of the property, both the vehicle's lien and the postpetition payments made by the debtor to Arcadia on the debt. Arcadia does not dispute the fact that the trustee possesses a superior lien right in the vehicle; however, the creditor disputes that the trustee has any right to the postpetition payments made by the debtor to Arcadia. The parties agree that this matter may be decided as a matter of law. Fed. R. Bankr. P. 7056.

This court has jurisdiction under 28 U.S.C. § 1334, and this is a core proceeding under 28 U.S.C. § 157(b)(2)(A), (O).

UNDISPUTED FACTS

The debtor took possession of the 1994 Isuzu Trooper on April 26, 1997. Around the same time, she borrowed funds to obtain the vehicle pursuant to a note and security agreement with Arcadia Financial, Ltd. Nevertheless, Arcadia's lien interest was not perfected until June 30, 1997, more than 20 days after the debtor took possession of the automobile. The debtor then filed for chapter 7 bankruptcy protection on August 5, 1997. Thus, the filing was less than 90 days after Arcadia's lien was perfected, and the lien was not protected from avoidance under 11 U.S.C. § 547(c)(3)(B).

The debtor and Arcadia signed a reaffirmation agreement dated September 5, 1997, which was filed with this court by Arcadia on October 23, 1997. The reaffirmation agreement contains the signatures of the debtor and a representative of Arcadia. However, the debtor's attorney only signed the notarization of the debtor's signature on the first page of the reaffirmation agreement. The attached affidavit of debtor's attorney, containing the debtor's attorney's name and address, as well as the declaration of attorney was blank.

After filing bankruptcy, the debtor remained in possession of the vehicle and continued to make monthly installment payments of $256.97 to Arcadia, pursuant to the reaffirmation agreement and earlier credit sale agreement, totaling $8,232.04. It is these payments which are in dispute. The trustee does not seek the two payments made after the lien was perfected but before filing, which total less than $600. 11 U.S.C. § 547(c)(8).

ARGUMENTS

The trustee contends that the estate is entitled to recover the value of Arcadia's lien on the day of the transfer, i.e., the date the lien was perfected. *In re International Ski Service, Inc.*, 119 B.R. 654, 659 (Bankr. W.D. Wis. 1990). The value of the lien at the time of transfer depends on the value of the collateral and the amount owed on the purchase contract. On the petition date, the value of the collateral was between the purchase price, $17,000, and the value shown in the reaffirmation agreement, $16,800. The principal amount owed at the time the reaffirmation agreement was entered into was $13,031.31, so the claim was fully secured. The trustee points out that the purpose of 11 U.S.C. § 550 is to restore the estate to the financial condition in which it would have been had the transfer not occurred. Each payment made by the debtor and retained by Arcadia diminished the value of the lien. Arcadia should not, contends the trustee, be able to receive the benefit of the payments at the expense of the estate.

Arcadia argues that the debtor's postpetition payments were not made with estate property and, therefore, not subject to recovery by the trustee. The goal of awarding a recovery under § 550 is to return to the estate only what the estate lost as a result of the preferential transfer. Here, the transfer was the perfection of the lien on property of the estate, not the debtor's postpetition transfer of monthly payments made with postpetition income, as the debtor's earnings would not have been property of the estate. 11 U.S.C. § 541(a)(6). The proper remedy, asserts Arcadia, is avoidance of the lien and the subsequent enhancement of the value of the vehicle in its character as property of the estate, to the extent it is free and clear of the lien.

DISCUSSION

Recovery of Postpetition Payments

The avoidance of the lien is not disputed by Arcadia (Defendant's brief at p. 7). If the lien is avoided, it is preserved for the benefit of the estate, which means that the trustee, instead of Arcadia, can collect the monthly payments on the vehicle going forward. 11 U.S.C. § 550(a). Around $8,000 is still owed on the car.

In addition to payments on the lien going forward, the trustee wants the payments received by Arcadia before avoidance of the lien. Cases addressing the return of postpetition payments made by the debtor to the creditor before lien avoidance have usually turned on whether the estate was diminished by the payments. For example, in *In re Smith*, 236 B.R. 91, 101 (Bankr. M.D. Ga. 1999), the bankruptcy court determined that the trustee was not entitled to recover five monthly installments of $206.71 the debtor made to the bank postpetition in satisfaction of a lien that was later avoided. The payments were made with the debtor's postpetition income. The court reasoned that because such income was not property of the estate under § 541(a)(6), the estate suffered no loss as a consequence of those payments. *Id.*; *see also In re Closson*, 100 B.R. 345 (Bankr. S.D. Ohio 1989) (trustee who successfully avoided creditor's lien as preferential, was not subsequently entitled to recover postpetition payments made by debtor pursuant to terms of original contract with creditor and postpetition reaffirmation agreement). Likewise, in this case, the postpetition payments were made by the chapter 7 debtor with her postpetition income and, therefore, the payments did not constitute property of the estate.

While not stated by the parties precisely this way, the trustee is attempting to characterize the avoided lien as property of the estate retroactively. This is not an entirely unreasonable interpretation of the avoidance mechanism, since the purpose of § 550 is to bring property into the estate as if the transfer had never been made. *Smith*, 236 B.R. at 100. An avoided lien is described as being "void ab initio" from the time of the transfer. *Id*. If the court could use a time machine to fashion a remedy, the debtor would have been making payments to the trustee for the nonexempt value of her unencumbered vehicle from the filing of the petition. The debtor's payments on the lien would become property of the estate, notwithstanding the fact that they were made with her postpetition earnings.

The code deals with the lack of a time machine by the remedy provided in § 550. Section 550(a) of the bankruptcy code provides that the bankruptcy estate may recover the property transferred, or, if the court so orders, the value of the property may be recovered. Cases have suggested, and the parties seem to agree, that the decision to return the property or its value is at the discretion of the bankruptcy court. *Matter of Farmer*, 209 B.R. 1022, 1024 (Bankr. M.D. Ga. 1997); *In re International Ski Service, Inc.*, 119 B.R. 654, 656 (Bankr. W.D. Wis. 1990). That is, there must be a reason to require payment of the value of the property transferred; it is not merely an election of the alternative remedy preferred by the trustee.

Some courts have concluded that when the value of the property is difficult to identify or has diminished by depreciation, the value of the property should be recovered. *See In re Classic Drywall, Inc.*, 127 B.R. 874, 877 (D. Kan. 1991) (some of the property transferred had been sold by the creditor, and there was conflicting evidence on what remained); *In re Apollo Hollow Metal Hardware Co.*, 71 B.R. 179, 183 (Bankr. W.D. Mo. 1987) (some inventory was consumed by

creditor, but creditor was ordered to transfer remaining truck to trustee); *but see In re Computer Universe, Inc.*, 58 B.R. 28, 32 (Bankr. M.D. Fla. 1986) (value of computer equipment used for one year by defendant was ordered to be paid to estate because of depreciation).

One bankruptcy court took the view that the option to make a cash award is one that should be employed in limited circumstances, and only where the voiding of the lien is inadequate or unavailable as a remedy. The court in *Matter of Farmer*, 209 B.R. 1022, 1025 (Bankr. M.D. Ga. 1997), noted that the "enhancement of value [created when a lien in the debtor's property was avoided under section 547] is itself a recovery of 'the property transferred' as contemplated by" section 550. *Id*. In other words, as the lien is paid down, the equity in the asset goes up. To the extent this increased equity is not exempt, the increase is property of the estate. Because the vehicle subject to the avoided lien was in the debtor's possession, it was easily available to be administered by the trustee as an asset of the estate. Recovery of the property in form of avoidance of the lien, not an award of monetary value, was thus the appropriate remedy. *Id*. at 1025-26.

The same is true in this case. The debtor still owns the car. True, the equity in the car probably has not increased dollar for dollar as payments were made to Arcadia. Part of those payments were interest, and cars typically depreciate over time with use. However, much of this difference could have been mitigated by prompt lien avoidance shortly after filing, and the delay is no reason to modify sound legal principles. Allowing the estate both the dollar amount of the payments, plus the increase in value due to those payments, would be akin to double recovery. Lien avoidance is the trustee's sole remedy.

Reaffirmation Agreement

The parties disagree whether or not the reaffirmation agreement was valid and whether or not it affects the outcome of this issue. In a reaffirmation agreement, a debtor agrees to pay all or part of a dischargeable debt. *Matter of Duke*, 79 F.3d 43, 44 (7th Cir. 1996). To be enforceable, a reaffirmation agreement must comply with 11 U.S.C. § 524(c), which provides in pertinent part:

> An agreement between a holder of a claim and the debtor, the consideration for which, in whole or in part, is based on a debt that is dischargeable in a case under this title is enforceable only to any extent enforceable under applicable nonbankruptcy law, whether or not discharge of such debt is waived, only if --
>
> . . .
>
> (3) such agreement has been filed with the court and, if applicable, accompanied by a declaration or an affidavit of the attorney that represented the debtor during the course of negotiating an agreement under this subsection, which states that --
>
> > (A) such agreement represents a fully informed and voluntary agreement by the debtor;
> > (B) such agreement does not impose an undue hardship on the debtor or a dependent of the debtor; and
> > (C) the attorney fully advised the debtor of the legal effect and consequences of --
> > > (i) an agreement of the kind specified in this subsection; and
> > > (ii) any default under such an agreement[.]

11 U.S.C. § 524(c). These statutory requirements exist to prevent debtors from being coerced into signing reaffirmation agreements and to enable them to be fully aware of the consequences of the agreement. *In re Smurzynski*, 72 B.R. 368, 371 (Bankr. N.D. Ill. 1987); *see also* S. Rep. No. 103-168, sec. 104 (1993).

Reaffirmation agreements thwart the bankruptcy principle of giving honest debtors a fresh start because they burden individuals with the obligation to repay dischargeable prepetition debts after bankruptcy. Therefore, in order to protect such debtors and the goals of bankruptcy, several courts have found that reaffirmation agreements should be strictly construed. *See In re*

Kamps, 217 B.R. 836, 841 (Bankr. C.D. Cal. 1998); *In re Artzt*, 145 B.R. 866, 868 (Bankr. E.D. Tex. 1992); *In re Petersen*, 110 B.R. 946. 949-50 (Bankr. D. Colo. 1990).

Debtor's counsel filed an affidavit in conjunction with Arcadia's brief containing a statement that her failure to sign the attorney's declaration on the second page was inadvertent. She had explained to the debtor the legal effect of the reaffirmation agreement at the time it was signed by the debtor and believed that it did not impose an undue hardship on the debtor.

Notwithstanding the affidavit of the debtor's counsel, the reaffirmation agreement was defective when it was filed and was not amended prior to the debtor's discharge. Because the reaffirmation agreement did not comply with § 524(c), it is unenforceable. Nevertheless, the defective agreement has no affect on the outcome of this case. True, in this circuit the creditor could have recovered the car in the absence of a valid reaffirmation agreement. *See Matter of Edwards*, 901 F.2d 1383 (7th Cir. 1990). Receipt of payments, however, dampens the desire of most creditors to do so. Arcadia chose to accept payments pursuant to what was still a valid lien until avoided by this action. In all likelihood, the reaffirmation agreement was not scrutinized for efficacy until after the trustee brought up the issue of the lien. As is discussed in the previous section, the trustee's right to recover postpetition payments from a creditor does not turn on the debtor's obligation to pay.

Actually, the court, and probably the debtor as well, is pleased not to have to deal with the debtor's liability on a valid reaffirmation agreement to a creditor who no longer has a lien on the debtor's vehicle, coupled with the possible enforcement of the trustee's lien on the same vehicle. The court in *Farmer*, 209 B.R. at 1025, bemoaned the apparent unfairness of such a situation without deciding it, and this court has no need to.

CONCLUSION

For the reasons discussed above, the trustee's motion for summary judgment is granted in part and denied in part. Arcadia's security interest is avoided, pursuant to § 547, and preserved for the benefit of the estate, pursuant to § 551. Furthermore, Arcadia shall not be required to turn over the postpetition payments made by the debtor.

A separate order consistent with this decision will be entered.

Dated at Milwaukee, Wisconsin, May 8, 2000.

BY THE COURT
___/s/_____
Honorable Margaret Dee McGarity
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

In re

Case No. 97-27648

TAMERA RICH,

Chapter 7

Debtor.

TODD ESSER, TRUSTEE,

Plaintiff,

v. Adversary No. 99-2131

ARCADIA FINANCIAL, LTD.

Defendant.

ORDER GRANTING, IN PART, AND DENYING, IN PART,
PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

For the reasons set forth in the court's memorandum decision entered on this date, IT IS ORDERED that the trustee's motion for summary judgment is granted in part, and Arcadia's security interest is avoided, pursuant to § 547, and preserved for the benefit of the estate, pursuant to § 551.

IT IS FURTHER ORDERED that the trustee's motion for summary judgment is denied in part, and Arcadia shall not be required to turn over the postpetition payments made by the debtor.

IT IS FURTHER ORDERED that each party will bear its own costs.

Dated at Milwaukee, Wisconsin, May 8, 2000.

BY THE COURT

____/s/_____
Honorable Margaret Dee McGarity
United States Bankruptcy Judge

108:05/08/00