UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
ROOM 211
FEDERAL BUILDING AND U.S. POST OFFICE
225 SOUTH PIERRE STREET
PIERRE, SOUTH DAKOTA 57501-2463

IRVIN N. HOYT
BANKRUPTCY JUDGE

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April 10, 1989

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Re: Leland and Mari Rapp
Chapter 7; 87-10354
Adversary 88-1031

Dear Counsel:

The Court has considered the parties' briefs, exhibits and testimony and renders the following opinion in this adversary matter.

Mr. Rapp executed two promissory notes in favor of Eureka State Bank. The first note was executed June 2, 1986 in the amount of $3,500.00 and was secured by a 1982 Chevrolet pickup. Exhibit 4 contains a copy of the pickup title issued June 17, 1986 to Rapp's Jack & Jill. The Bank is listed as the lien holder on this title.

The second note in the amount of $12,000.00 was signed November 6, 1986, and extends the payment of an earlier $12,000.00 note signed December 5, 1985 in favor of the Bank.

In November, 1987 the Rapps allegedly were in default on the notes, although this point is disputed by the Trustee. In this month the debtors and Bank entered into the following agreement. The Bank would forego its right to offset the Rapp Jack & Jill checking account maintained at the Bank, which was the debtors' business account, against amounts due on the notes, which presumedly the Bank had accelerated. The Bank's setoff rights are premised on terms of the note and SDCL 51-24-15. In

exchange for the Bank's forbearance, the debtors agreed to pay the Bank $2,000.00, which apparently was the approximate balance

in the business checking account, and to forfeit the pickup.

A November 20, 1987 notation on the back of the larger notes reflects the Bank's receipt of the $2,000.00 cash payment. The pickup was sold at an undisclosed date for $4,200.00. A December 4, 1987 notation on the back of the smaller note reflects that $2,006.61 of the proceeds were credited to the smaller note, which paid the note in full. An entry of the same date on the back of the larger note reflects that the remaining $2,193.39 in proceeds were credited to the larger note, reducing its balance to $4,760.81. Under the terms of the parties' agreement, this remaining balance is written off.

The debtors filed their Chapter 7 petition December 1, 1937. This is a no asset case. The title to the pickup was not assigned to the Bank, but rather to Lyle Jensen, who apparently purchased the pickup from the Bank. The title was not assigned until March 31, 1988.[1] The Bank's lien is marked canceled December 16, 1987. The Chapter 7 Trustee filed the present adversary September 22, 1988 attacking the above transactions as avoidable setoffs or preferences.

Analysis

The agreement between the debtors and the Bank make it clear, and the parties in their briefs concede, that no setoff occurred. Therefore, the rights of the parties are not determined by Section 553 of the Code. Instead, the Trustee properly relies solely Section 547 of the Code which avoids certain preferential transfers.

Section 547(b) sets forth five elements of an avoidable preferential transfer of an interest in the debtors' property. Bank concedes all but the fifth element. This element is codified in Section 547(b)(5). To apply this prong of the test the Court must compare what the creditor received as a result of the challenged transfer, plus any additional recovery the creditor would receive in bankruptcy, against what the creditor would have recovered in a Chapter 7 bankruptcy had the transfer not been made. See 4 Collier on Bankruptcy para. 547.08 (15th ed. 1989).

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[1] Neither party to this adversary has addressed the somewhat troubling fact that some of the transfers in question apparently took place post-petition.

The following is what the Bank received as a result of the assailed transfers:

debt on smaller note paid in full by liquidating collateral	$ 2,006.61
debt on larger note reduced by a. cash payment	+$ 2,000.00
b. remainder of collateral proceeds	+$ 2,193.39
total amount received	=$ 6,200.00

The remainder of the debt was discharged and Bank would thus receive no further payment in bankruptcy, even if assets were located to apply to Bank's otherwise existing unsecured claim.

The following is what Bank would receive in Chapter 7 had the transfer not occurred.

claim on smaller note over-collateralized and thus paid in full	$ 2,006.61 + + interest + fees, etc. allowed by §506(b)
debt on larger note of $8,954.20, an undersecured debt, would consist of a. secured claim	+ $ 2,362.43 (approximately)
b.unsecured claim $6,519.77	+unknown dividend
total amount received	= $ 4,369.04 + 506(b)allowances + dividend

Although there is no evidence of a security agreement securing the larger note, the Banks secured claim arises under the banker's lien provided by SDCL 44-11-11. See also Western Surety Company v. First Bank of South Dakota, 427 N.W. 2d 840 (S.D. 1988). The size of the secured claim

approximated above is based upon the $362.43 closing balance of the checking account on November 30, 1987, the eve of bankruptcy, garnered from Exhibit 3. It is an approximation favoring the Bank, because it assumes that had the $2,000.00 not been paid to the Bank prior to bankruptcy the money would have remained in the debtors' checking account until the date the petition was filed and been subject to the banker's lien.

It is impossible to accurately estimate the dividend the unsecured claim would receive in Chapter 7, because it is not known what administrative expenses may need to be paid prior to distribution to unsecured creditors (see Section 726), and what other general unsecured claims will also receive a dividend. Since this is a no asset case, the filing of proofs of claim has not even been allowed. Since the $2,193.39 in "excess" collateral securing the smaller note will be returned to the estate, it is possible that the estate will have assets to pay general unsecured claims a small dividend. The amount the creditor would have received in Chapter 7 is further unknown because the Court also does not know what §506(b) fees and interest the creditor has a right to add to the fully secured claim.

Although it is not possible to state with accuracy the amount the Bank would receive in a Chapter 7 bankruptcy had the transfer not occurred, it is most probable that this amount is less than the $6,200.00 it received shortly before the petition date. The difference between the two amounts was a preference to the Bank which must be returned to the Chapter 7 Trustee. The preference is accounted for by the Bank's failure to cross collateralize the larger note to the collateral securing the smaller note. Under the November agreement the Bank applied the "excess" proceeds from this collateral to the larger unsecured note, thus accounting for the preference. The Bank has no right to apply the collateral to the unsecured note in bankruptcy.

The Bank and the Trustee must attempt to determine the amount of the preference by estimating the amount the Bank would have received in Chapter had the November transfers not taken place. If they are unable to do so, they must schedule an evidentiary hearing providing the Court a factual basis on which it can determine the amount the Bank would receive in Chapter 7 had the transfer not occurred.

This letter opinion constitutes the Court's findings of fact and conclusions of -law in this adversary matter. This matter constitutes a core proceeding under 28 U.S.C. Section 157(b)(2). The Court shall enter an appropriate order.

Very truly yours,

Irvin N. Hoyt
Chief Bankruptcy Judge

INH/ sh
CC: Bankruptcy Clerk
Curt Ewinger, Esq.