11 U.S.C. § 542
11 U.S.C. § 550

Lansdowne v. Hildreth — Civil No. 90-6404-JO
Adversary No. 687-5053-H
In re Cox — Bankruptcy Case No. 684-08450-H7

12/19/90 District Ct. (Judge Jones) affirming PSH unpublished

Eight months prior to the filing of several consolidated involuntary bankruptcies, the debtor transferred two apartment buildings by land sale contract. The LSKs contained forgeries of his wife's signature (a consolidated debtor) and were never recorded. The trustee plead alternative theories under § 547 and § 542, seeking turnover of the property plus $177,821.78 in rents collected between the date of transfer and the date of recovery. The bankruptcy court determined that the transfers were voidable preferences under § 547 and awarded the trustee the real property plus $23,001.78 in rents after determining the transferee was a "good faith transferee" entitled to an improvement lien under § 550(d). Under the § 542 claim, the bankruptcy court determined the trustee was only entitled to ½ the real property plus $11,500.89 in rents because the transferee took the property as co-tenant with the debtor's wife and her share of the rents were subject to proportionate contribution for expenses. The trustee appealed both recoveries, arguing entitlement to all the rents.

The trustee argued that the rental income generated by the properties and recovered by the trustee was not subject to an improvement lien as it is not "property recovered" under the language of § 550(d). The trustee also argued that good faith status must be determined at the time the transfer was made; namely "immediately before the date of filing of the petition," under § 5479e)(2)(C), as the transfers were never perfected. The district court held that rental income was "property recovered" and that good faith status turns on a factual determination where the definition of "transfer" at § 101(54), rather than § 547(e), controls. Thus the § 550(d) improvement lien applied to all reasonable expenses incurred in collecting the rents for the period of time between the transfer of the LKSs and the filing of the bankruptcies as well as up to the date of recovery by the trustee, where the transferee reinvested the rents back into the property.

The trustee also argued that debt service was not subject to the improvement lien because the bank's lien was undersecured and was thus void. The district court rejected this argument as well as the trustee's assertion that an assumption agreement with the

bank signed by the transferee constituted a novation which relieved the debtor's wife from her duty to contribute as a co-tenant under the trustee's alternate § 542 claim.

C-Campbell, Slucombe 12-20-90

U.S. DISTRICT COURT
DISTRICT OF OREGON
SOUTHERN DIVISION
FILED
DEC 19 1990
ENTERED 12-20-90
DONALD M. CINNAMOND, CLERK
BY DEPUTY

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF OREGON

In Re: S.D. COX INVESTMENTS, INC., STEVEN D. COX, DEBORAH M. COX, EUGENE R. RICHMOND, Debtors.	Bankruptcy No. 684-08450-H7 Civil No. 90-6404-JO
PAUL LANSDOWNE, INC., Trustee, Plaintiff-Appellant, v. DOUGLAS H. HILDRETH, Defendant-Appellee.	Adversary No. 687-5053-H OPINION AND ORDER

JONES, Judge:

This is an appeal from the bankruptcy court's order and amended judgment in favor of the bankruptcy trustee.

Background

On February 21, 1984, the debtors, Steven Cox and Deborah Cox, entered into two agreements with the Central Point State Bank ("bank").[1] Under the agreements, the bank agreed to sell to the

[1] The Central Point Bank is now the Crater Bank.

debtors two apartment buildings. The conveyance was in the form of a land sale contract.

On February 27, 1984, the debtors entered into an agreement to sell the properties to appellee, Dr. Hildreth. Prior to this transaction, Dr. Hildreth had been an investor with S.D. Cox Investments, Inc., a company owned by the debtors. The down payment for the purchase of the properties was provided by transferring to the debtors a promissory note previously executed by the debtors for the benefit of Dr. Hildreth. The signatures of the debtors on the land sales agreements between the debtors and Dr. Hildreth were not acknowledged and the land sales agreements were not recorded in the county recording index. Unknown to Dr. Hildreth, the signature of Deborah Cox on the land sales agreements between the debtors and Dr. Hildreth was forged by an unidentified person and not authorized by Deborah Cox.

The properties were managed by Cox Property Management, a property management company owned by the debtors. The tenants residing in the apartment buildings on the properties were not notified of the change in ownership from the debtors to Dr. Hildreth. Cox Property Management managed the properties and collected rent payments from February, 1984 through September, 1984. In late September, 1984, the debtors fled the state with the assets of several investors, including several thousand dollars which Dr. Hildreth had previously invested with the debtors. In early October, 1984, Dr. Hildreth employed a new property management company.

Between February 27, 1984, and the time of trial, April 25, 1989, the properties generated $177,821.78 in rental income. The rental income generated by the properties was used by Dr. Hildreth to make payments to the bank on the debt owed to the bank and secured by a lien on the properties. The rental income was also applied to pay property taxes, pay repair and maintain costs of the properties, and applied to insurance premiums and management fees. Dr. Hildreth paid an additional $15,015.87 of his own funds for property taxes.

On October 18, 1984, an involuntary chapter 11 petition was filed against S.D. Cox Investments, Inc. On October 29, 1984, involuntary chapter 11 petitions were filed against Steven Cox and Deborah Cox. In March, 1985, appellant, Paul Lansdowne, Inc., was appointed trustee for the bankruptcy estate. On March 3, 1987, the trustee filed this adversary proceeding against Dr. Hildreth. The trustee sought to recover the two apartment buildings and the rents received from the properties.

In its initial order and judgment, the bankruptcy court determined that the conveyance of the apartment buildings from the Coxes to Dr. Hildreth was a preferential transfer which could be avoided under 11 U.S.C. § 547. Pursuant to 11 U.S.C. § 550(a), the bankruptcy court allowed the trustee to recover from Dr. Hildreth the real property and the rents generated by the properties. The bankruptcy court allowed Dr. Hildreth a set-off and credit against the judgment for payments made to the bank during the period between February 27, 1984, and the date of

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filing of the bankruptcy petition. The bankruptcy court also allowed Dr. Hildreth a set-off and credit for insurance premiums paid during the pre-petition period.

Subsequently, Dr. Hildreth moved the bankruptcy court to amend its judgment. Dr. Hildreth's motion was granted and the judgment was amended by a letter opinion granting Dr. Hildreth an improvement lien under 11 U.S.C. § 550(d) in the amount of $155,953.69. This amount reflected Dr. Hildreth's expenditures for property taxes, debt service to the bank, repair and maintenance costs, and management fees. Accordingly, the trustee was awarded the properties plus a money judgment of $21,686.09 against Dr. Hildreth.

The trustee then moved the court to reconsider. The trustee's motion was granted and the court's judgment and order were amended by a second letter opinion enhancing the trustee's award by reducing Dr. Hildreth's improvement lien to the extent that claimed management fees totaling $1,133.69 had not actually been paid by Dr. Hildreth.

In the second amended order and judgment, the bankruptcy court found that, under Oregon law, the Coxes had held the properties as tenants by the entirety. Judge Higdon determined that Deborah Cox's signature on the February 27, 1984 land sales agreements between the Coxes and Dr. Hildreth was an unauthorized forgery. Therefore, the transfer of the property to Dr. Hildreth by Steven Cox with Deborah Cox's forged signature did not destroy

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Deborah Cox's right of survivorship or present right to one-half of the rents and profits.

The bankruptcy court held that Dr. Hildreth took title as a tenant in common with Deborah Cox and, therefore, Deborah Cox continued to be entitled to her one-half share of the rents and profits of the properties. The court also found that Dr. Hildreth was entitled to contribution for repair and maintenance costs from Deborah Cox. Pursuant to 11 U.S.C. § 542, Judge Higdon allowed the trustee to recover one-half the rents less one-half the expenses for a total recovery of $11,500.89.

The claim under the 11 U.S.C. § 542 was plead in the alternative and based on the same underlying facts as the trustee's claim under 11 U.S.C. § 547. The bankruptcy court determined that the trustee was limited to a single satisfaction of either $23,001.78 under the 11 U.S.C. § 547 claim, or $11,500.89 under the 11 U.S.C. § 542 claim.

Jurisdiction

The court has jurisdiction under 28 U.S.C §§ 158(a) and 1334.

Scope of Review

The court reviews questions of law *de novo*, but upholds the bankruptcy court's findings of fact unless they are clearly erroneous. In Re Rubin, 875 F.2d 755, 758 (9th Cir. 1989).

Discussion

The trustee appeals from the bankruptcy court's second amended order and judgment. The trustee identifies twelve issues on appeal. The defendant does not cross-appeal.

A. The Section 547 Claim

Section 547 of the Bankruptcy Code allows the trustee in bankruptcy, in certain circumstances, to "avoid" or undo transfers of a debtor's property made within a time period fixed by the Code.[2] 11 U.S.C. § 547.

Section 550(a) of the Code allows the trustee to recover property subject to an avoided transfer. 11 U.S.C. § 550(a). Section 550(d) also grants a good faith transferee an "improvement lien" against the property recovered from the transferee by the trustee. 11 U.S.C. § 550(d).

The amount of the improvement lien is limited to the lesser of: 1) the cost, to the transferee, of any improvement made after the transfer, less the amount of any profit from the property; and 2) any increase in the value of the property as result of improvements made by the transferee. 11 U.S.C. § 550(d)(1).

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[2] Section 547(b) of the Code provides:

"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 owed by he 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.

The bankruptcy court found that the conveyance of the apartment buildings from the Coxes to Dr. Hildreth was an avoidable preference under 11 U.S.C § 547.[3] Pursuant to 11 U.S.C § 550(a), the bankruptcy court authorized the trustee to recover the property subject to the avoided transfer. The bankruptcy court also found that Dr. Hildreth was a good faith transferee and granted him an improvement lien under 11 U.S.C. § 550(d).

1. The Date of Transfer

The bankruptcy court determined Dr. Hildreth's good faith transferee status as of the date he took "control" of the property. The bankruptcy court found the date of taking control of the property to be the date of conveyancing, and found Dr. Hildreth to be a good faith transferee on that date. The trustee argues the transferee's good faith status must be determined at the time the transfer is "made" as that term is defined in the avoidance provision of 11 U.S.C. § 547.

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[3] Dr. Hildreth acknowledges that no cross-appeal was filed yet asserts that the bankruptcy court erred in determining the transfer was an avoidable preference. Section 547(b) sets forth the elements which the trustee must establish to show a transfer was preferential. 11 U.S.C. § 547(b)(1)-(b)(5). Dr. Hildreth charges that the evidence did not establish that Dr. Hildreth received more from the transaction than if the transfer never occurred and the debtor's estate was liquidated and distributed under Chapter 7 of the Code. 11 U.S.C. § 547(b)(5). This issue was raised and argued at trial. Both the trustee, (Tr. Vol. I, May 4, 1989, at 3 - 8 and 41 -55), and Deborah Stone, (Tr. Vol. I, May 4, 1989, at 9 - 31), testified at length on this issue. The bankruptcy court found that the trustee "put on ample evidence that the provision was complied with . . . ." (Tr. Vol. III, May 5, 1989, at 344). The bankruptcy court's determination of this issue is supported by the record. Moreover, because Dr. Hildreth does not cross-appeal, and may only urge the matter to support the judgment rendered below, I need not inquire further into the correctness of the bankruptcy court's determination of this issue. See United States v. 101.80 Acres of Land, 716 F.2d 714, 727 n.24 (9th Cir 1983)(citing to United States v. American Railway Express Co., 44 S.Ct. 560, 563 (1924)).

Under the trustee's proposition, the transferee's good faith would be determined at a time fixed by the Code for purposes of determining if the transfer was a preference, not at the time the transfer was actually executed by the parties. Under section 547, a preferential transfer is "made":

> (A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 10 days after, such time;
> (B) at the time such transfer is perfected, if such transfer is perfected after such 10 days; or
> (C) immediately before the date of the filing of the petition, if such transfer is not perfected at the later of-
>
> (i) the commencement of the case; or
> (ii) 10 days after such transfer takes effect between the transferor and transferee.

11 U.S.C. § 547(e)(2).

The parties do not dispute that the transfer of the properties from the debtors to Dr. Hildreth was not perfected. Thus, for purposes of determining if the transfer was a preference, the transfer was "made" immediately before the date of the filing of the case.

However, the definition of when a transfer is "made" for purposes of determining whether the transfer was a preference 11 U.S.C. § 547 is expressly limited by subsection (e)(2) which begins: "For purposes of this section . . . a transfer is made when . . . ." 11 U.S.C. § 547(e)(2). Moreover, the rules of construction set forth in section 102 state that "a definition contained in a section of this title that refers to another section of this title, does not, for the purpose of such reference, affect the meaning of a term used in such other section." 11 U.S.C. § 102(8). Thus, when a transfer is "made"

for purposes of 11 U.S.C. § 547 is not necessarily useful in determining if the transferee was a "good faith transferee" for purposes of 11 U.S.C. § 550.

Beyond the fact that 11 U.S.C. §§ 547 and 550 use the word "transfer", there is no reason to assume that Congress intended the date a transfer for purposes of determining the transferee's good faith status under 11 U.S.C. § 550 to be transplanted from the date of transfer a transfer is "made" under 11 U.S.C. § 547. This is amplified by the fact that the two Code sections serve conceptually different ends.

Section 547 grants the trustee the authority to avoid certain transfers. 11 U.S.C. § 547. The purpose of 11 U.S.C. § 547(e) is limited to establishing the trustee's right to avoid certain pre-petition transfers. The statute fixes a point in time when a transfer occurs in order to make the legal determination of whether the transfer is a preference.

Section 550, on the other hand, sets forth the liability of the transferee of an avoided transfer. 11 U.S.C. § 550(a). Section 550(a) "enunciates the separation between the concepts of avoiding a transfer and recovering from the transferee." 4 Collier on Bankruptcy, Para. 550.01 at 550-2 (15th Ed. 1979). The purpose of section 550(a) is to restore the financial condition of the estate to the state in which it would have been had the transfer never occurred. In re Blackburn, 90 B.R. 569, 573 (Bankr. M.D. Ga. 1987). Section 550(d) creates a lien to secure the value of improvements made by a good faith transferee from

whom property has been recovered pursuant to section 550(a). 4 Collier on Bankruptcy, Para. 550.01 at 550-3.[4]

Several decisions imply that the transferee's good faith status should be determined on the date of transfer as effective between the parties, not the date when the transfer was "made" under 11 U.S.C. § 547(e). See e.g., In re Brooklyn Overall Co., Inc., 57 B.R. 999, 1004 (Bankr. E.D. N.Y. 1985) (rights of transferee are determined by looking to the time of assignment); In re Black & White Cattle Co., 783 F.2d 1454, 1462 (9th Cir. 1986) (transferee's good faith determined by looking to the evidence of parties' intent at the time of the parties' agreement); In re Brown Iron and Metal, Inc., 28 B.R. 426, 430 (Bankr. E.D. Ten. 1983) (date transfer "made" for purposes of section 548 not date used in determining date of improvements for purposes of section 550(d)); see also 4 Collier on Bankruptcy, Para. 550.03 at 550-110(with respect to pre-petition transfers that are recoverable, court should ask whether transferee had reasonable cause to believe that a petition would be filed).

In re Blackburn, relied on by the trustee, is not contrary. In that case, the bankruptcy court looked to the date the transfer was "made" under section 547(e) in order to establish the value

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[4] Section 550(d)(1) provides:
"A good faith transferee from whom the trustee may recover under subsection (a) of this section has alien on the property recovered to secure the lessor of--

(A) the cost, to such transferee, of any improvement made after the transfer, less the amount of any profit realized by or accruing to such transferee from such property; and
(B) any increase in the value of such property as a result of such improvement, of the property transferred."

of the property transferred by the debtor and recovered by the trustee. In re Blackburn, 90 B.R. at 573. The court held that because the trustee sought to recover the value of the property and not the property itself, and because the property had depreciated, the trustee could recover the properties value at the time the transfer was "made" as defined by section 547. Id. The court, however, expressly recognized that "the time at which the value is measured depends upon the circumstances of each individual case." Id.

A transferee's good faith status is determined on a case-by-case basis. In re Blitstein, 105 B.R. 133, 137 (Bankr. S.D. Fla. 1989). The court must determine if a reasonable person, standing in the shoes of the transferee, knew or should have known the transfer was motivated by a desire to defraud the debtor's creditors. 4 Collier on Bankruptcy, Para. 550.02 at 550-9, n. 3; In re Robbins, 91 B.R. 879, 886 (Bankr. W.D. Mo. 1988).

The good faith provisions of 11 U.S.C. § 550 necessarily require a factual determination. See e.g., Robbins, 91 B.R. at 886-87. It is unclear how the court could make a factual determination if the court is required to look to the time fixed by section 547(e), which in many cases may be several months or years after the transfer has been effected between the parties.

The bankruptcy court's "control" test is more appropriate for determining a transferee's good faith status. The bankruptcy court's test allows the court to make the necessary factual determination based on the actions and manifestations of the

intent of the parties at the time the property changed hands. However, as the trustee points out, the term "control" may be too ambiguous to be helpful.

The Code defines a transfer as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of, or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption." 11 U.S.C. § 101(54). When Steven Cox and Dr. Hildreth executed the two sales agreements on February 27, 1984, Steven Cox voluntarily parted with his interest in the two apartment buildings. On that same date, Deborah Cox parted, albeit involuntarily, with an interest in the apartment buildings. The record supports the bankruptcy court's finding that at the time the Coxes parted with their interests in the properties, Dr. Hildreth did not know, and could not have known, that the Coxes would later forsake their obligations to their creditors.

I conclude that for purposes of 11 U.S.C. § 550(d), the determination of whether a transferee acted in good faith must be made by considering the circumstances as they existed at the time of "transfer" as that term is defined in section 101(54). In this case, that date was February 27, 1984. At the time of transfer, Dr. Hildreth acted in good faith in dealing with the Coxes. The bankruptcy court did not err in determining Dr. Hildreth's good faith transferee status on February 27, 1984. Therefore, the

bankruptcy court did not err in excluding evidence relating the issue of good faith for the period after February 27, 1984.

2. Property Subject to a Good Faith Transferee's Improvement Lien

The bankruptcy court granted Dr. Hildreth an improvement lien on rental income which was generated by the properties and recovered by the trustee. The bankruptcy court held that the term "property recovered" included the real properties transferred and rental income generated by the property. The bankruptcy court went on to find that, because rental income is properly considered "property recovered", a good faith transferee is entitled to an improvement lien against rental income recovered by the trustee.

a. Rents are Property of the Estate

The trustee argues that the bankruptcy court erred in finding that rental income generated by the properties and recovered by the trustee was subject to an improvement lien. The trustee contends that rents generated by the properties before the trustee actually recovers the property are not property of the estate and therefore cannot be the subject of an improvement lien.

The commencement of a case creates an estate. 11 U.S.C. § 541. The estate is made up of certain property including any interest in property the trustee recovers under section 550(a) and rents generated by property of the estate "wherever located and by whomever held at that time." 11 U.S.C. § 541(a)(3) & (6). I find that rental income generated by the apartment buildings from the date of transfer is property of the estate recoverable under

11 U.S.C. § 550(a). See In re Burke, 60 B.R. 665, 669-70 (Bankr. D. Conn. 1986).[5]

b. Property Recovered Includes Rents

A good faith transferee "has a lien on the property recovered." 11 U.S.C. § 550(d)(1). When property is transferred by the debtor, and that transfer is determined to be a preference, the trustee is authorized by section 550(a) to recover the property and rental income generated by the property. The rental income generated by the property transferred and recovered pursuant to section 547 and 550(a) is properly characterized as "property recovered" under section 550(d) and is subject to a good faith transferee's improvement lien.[6]

The whole point of section 550(d) is to return a good faith transferee to the economic position he was in before the transfer was made. This goal is balanced against the general purpose of the Bankruptcy Code to maximize the debtor's estate.

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[5] This conclusion is supported by the reasoning of other bankruptcy courts.

> If, for example, a debtor transferred real property, defined under Code § 547 as a preference, the trustee could avoid the transfer and retrieve the property. If during the preference period, the transferee received rental payments . . . it would be incongruous for the transferee to be able to keep the rental . . . proceeds. The trustee would, under those circumstances, be entitled to the money as well as the return of the real property.

In re Burke, 60 B.R. at 669-70.

[6] Dr. Hildreth's comparison between rents and interest is misplaced. Interest is not included in the definition of property of the estate. 11 U.S.C § 541.

In In re Burke, relied on by the trustee, the bankruptcy court recognized these conflicting interests and denied a good faith transferee's improvement lien against rents generated by property recovered by the trustee under 11 U.S.C. § 549. The court reasoned that "[p]ermitting the transferee to keep the net proceeds of the property as well as the protection provided by the Code would give the transferee funds at the expense of the estate which could not have been intended by Congress." In re Burke, 60 B.R. at 670. In this case, Dr. Hildreth did not keep the rental income generated by the properties. Rather, Dr. Hildreth reinvested the rent proceeds into the property to preserve not only the market value of the property, but also the ability of the property to generate rental income.

I find that Dr. Hildreth was a good faith transferee entitled to an improvement lien against the property recovered by the trustee, and that the property recovered includes rents. The bankruptcy court's finding that Dr. Hildreth was entitled to an improvement lien against the property recovered, including rental income, was correct.

3. The Date of the Improvement Lien

The bankruptcy court found that Dr. Hildreth was entitled to an improvement lien for expenditures made by Dr. Hildreth from the date the sales agreements were executed, February 27, 1984. The trustee contends the court erred in allowing an improvement lien for expenditures made between the date the sales agreements were

executed and the date the transfer was "made" for under 11 U.S.C. § 547(e).

As a good faith transferee, Dr. Hildreth "has a lien on the property recovered to secure the lesser of-- (A) the cost, to such transferee, of any improvement made *after* the transfer . . . ." 11 U.S.C. § 550(d)(1)(A)(emphasis added). As previously discussed, for purposes of 11 U.S.C. § 550, a transfer takes place when the debtor parts with an interest in property. See 11 U.S.C. § 101(54). In this case, that date was February 27, 1984. The bankruptcy court's determination of this issue was correct.

4. The Amount of the Improvement Lien

The amount of a good faith transferee's improvement lien is determined under the formula set forth in 11 U.S.C. § 550(d)(1). The amount of the lien is limited to: 1) the lesser of the cost, to the transferee, of any improvement made after the transfer, less the amount of any profit from the property recovered; and 2) any increase in the value of the property recovered as result of improvements made by the transferee to the property transferred. 11 U.S.C. § 550(d)(1). The Code defines improvements broadly to include: 1) physical additions or changes, 2) repairs, 3) property tax payments, 4) certain loan payments, and 5) preservation of the property. 11 U.S.C. § 550(d)(2).

The bankruptcy court found that Dr. Hildreth made improvements to the property transferred. This finding is supported by the record. The bankruptcy court found that Dr. Hildreth paid property taxes on the transferred property. The

payment of property taxes is an improvement. 11 U.S.C. § 550(d)(2)(D). The bankruptcy court found that Dr. Hildreth made physical additions or changes to the transferred property. Making physical additions or changes is an improvement. 11 U.S.C. § 550(d)(2)(C). The bankruptcy court found that Dr. Hildreth made repairs to the property transferred. Repairs are improvements. 11 U.S.C. § 550(d)(2)(B). Implicit in the bankruptcy court's findings is that Dr. Hildreth made expenditures to preserve the property. Preservation of transferred property is an improvement. 11 U.S.C. § 550(d)(2)(E). Finally, the bankruptcy court found that Hildreth made payments on a debt secured by a lien on the property transferred and that the lien was superior or equal to the rights of the trustee. Payment on a debt secured by a lien on the property transferred where the lien is equal to or superior than the rights of the trustee is an improvement. 11 U.S.C. § 550(d)(2)(D).[7]

5. Increase in the Value of the Property Recovered

At trial, the bankruptcy court held that Dr. Hildreth's improvement lien was limited by 11 U.S.C. § 550(d)(1)(B) to the increase in the fair market value of the properties subsequent to the transfer. Because the fair market value of the properties had

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[7] The trustee charges that Dr. Hildreth failed to carry his burden of establishing that payments made to the bank were on a debt secured by a lien on the property equal to the rights of the trustee or that the bankruptcy court shifted the burden of proving this matter. This contention is without merit. The bankruptcy court found on the evidence presented by both parties that the payments were made on a debt secured by a lien on the property that was superior or equal to the rights of the trustee. This finding is not clearly erroneous.

not increased, Judge Higdon concluded that no improvement lien could be granted as the lesser amount would be $0.

On reconsideration, Judge Higdon held that because rents are properly considered property of the estate, the phrase "increase in the value of such property" used in 11 U.S.C. § 550(d)(1)(B) encompasses not only the fair market value of the real property but the value of the property recovered by the trustee by avoiding the transfer. The trustee argues that because the fair market value of the property transferred did not increase while in Dr. Hildreth's possession, there can be no improvement lien.

As previously discussed, the trustee may recover the "property transferred" and rents generated thereby. 11 U.S.C. § 550(a). A good faith transferee has a lien on the "property recovered" to secure either the cost of the improvement less any profit, or the increase in the value of "such property" as a result of the improvements to the "property transferred." 11 U.S.C. § 550(d)(1). The term "such property" refers to the property recovered by the trustee, not the property transferred by the debtor.

In this case, the property transferred was the two apartment buildings. Dr. Hildreth made improvements to the apartment buildings. The improvements were necessary to keep the property in a state of repair and to preserve the rental income generated by properties. The property recovered by the trustee was the two apartment buildings plus the rents generated by the buildings. The value of the property recovered, real property plus rents, was

increased by the expenditures made by Dr. Hildreth. The cost, to Dr. Hildreth, of the improvements was $154,820.00. The increase in the value of the property recovered was $177.821.78. The lesser of these is the cost, to Dr. Hildreth, of the improvements. Therefore, Dr. Hildreth has a lien on the property recovered to secure $154,820.00. 11 U.S.C. § 550(d)(1).

6. Payments to the Bank

The trustee next asserts that the payments made to the bank to service the underlying debt were "interest-only" payments which did not improve the estate's equity position in the property transferred. The trustee also contends that the terms of the bank's lien on the property transferred must create a right to rent proceeds in order for payments on that debt to qualify as improvements.

In order for payments on a debt to qualify as an improvement only two conditions need be met: 1) the debt must be secured by a lien on the property transferred, not the property recovered[8], and 2) the lien must be superior or equal to the rights of the trustee.[9] 11 U.S.C. § 550(d)(2)(D). Both conditions are met in this case.

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[8] Under 11 U.S.C. § 550(d)(2)(A) "improvement" includes "changes to the property transferred." Subparts (B) through (E) then refer to "such property." Clearly, "such property" as used in subparts (B) through (E) refers to the property transferred as used in subpart (A) not the property transferred. Therefore, under 11 U.S.C. § 550(d)(2)(D) payments made on a debt secured by a lien on "such property" refers to the property transferred, and not the property recovered as urged by the trustee.

[9] See supra note 6.

The trustee next asserts that at the time the case was commenced the debt due to the bank was $270,000, and that the evidence indicates the value of the properties at that time was only $267,500, therefore, the bank's lien was under-secured by $2,500. The trustee argues that under 11 U.S.C. § 506 the bank's lien is void and any amount paid on the debt cannot be considered as payment against a secured claim.

Section 506(a) provides that an under-secured creditor has a allowed secured claim only to the extent of the value of the collateral, and has an unsecured claim for the balance. 11 U.S.C. § 506(a). Section 506(d) provides that "[t]o the extent that lien secures a claim against a debtor that is not an allowed secured claim, such lien is void . . . ." 11 U.S.C. § 506(d). In this case, the bank has a secured claim of $267,500. The claim is void only to the extent it is not a secured claim which is $2,500. 11 U.S.C. § 506(d). I find, therefore, that the bank's lien was not void.

7. Dr. Hildreth's Motion

The trustee argues that on the bankruptcy court allowed, as part of the improvement lien, expenditures which Dr. Hildreth did not request as part of his motion to alter or amend judgment.

The record shows Dr. Hildreth filed a timely motion to alter or amend judgment. Bankruptcy Rule 9023. In that motion, Dr. Hildreth sought to reopen the bankruptcy court's ruling and requested certain expenditures as part of an improvement lien. Those expenditures were characterized as: 1) insurance premiums

in the amount of $3,994.00, 2) property taxes in the amount of $15,015.87, and 3) payments to the bank in the amount of $142,821.00. Pursuant to Dr. Hildreth's motion, the court requested clarification of the purpose for which the amounts requested were actually spent.

In its order, the bankruptcy court characterized the requested expenditures to reflect the evidence before it. The court divided those expenditures previously characterized as bank payments to reflect the amounts paid on each of the two properties. The court delineated between amounts actually spent to service the debt and amounts spent as management fees and other expenses such as repair and maintenance costs. The court simply re-characterized the expenditures sought by Dr. Hildreth in his Rule 9023 motion.

Furthermore, Rule 9023 refers to Rule 3008, which in turn provides that "[a] party in interest may move for reconsideration of an order allowing or disallowing a claim against the estate. The court after a hearing on notice shall enter an appropriate order." Bankruptcy Rule 3008. Judge Higdon's award was appropriate and did not exceed the scope of Dr. Hildreth's motion.

B. The Section 542 Claim

At trial, the trustee raised 11 U.S.C. § 542 as an alternative theory of recovery.[10] Section 542(a) requires, with certain exceptions, that any person in possession of property of

[10] Other alternative theories were raised at trial, however, the issues raised on appeal involve only sections 542 and 547.

the estate deliver that property to the estate. Judge Higdon found that, due to the forgery of Deborah Cox's signature, Dr. Hildreth took title to the properties as a tenant in common with Deborah Cox, and as a cotenant, Deborah Cox was entitled to a one-half share of the real properties and rents. Judge Higdon also determined that, as a cotenant, Deborah Cox was required to contribute toward expenditures on the properties. Thus, under section 542(a), the estate was entitled to delivery of Deborah Cox's one-half share of the real property and rents, subject to an set-off for contribution for one-half of Dr. Hildreth's expenditures for property taxes, insurance premiums, and repair and maintenance costs.[11]

1. Contribution

Under Oregon law, "[a] cotenant is required to bear a proportionate share of the expenses of maintaining and keeping property in repair and the cost of permanent improvements to which she consents." Lesser v. Lesser, 79 Or.App. 738, 720 P.2d 405, 406 (1986). Contribution for the costs of permanent improvements is required only where there has been "an express or implied agreement to that effect or if there are equitable considerations justifying contribution." Palmer v. Protroka, 257 Or. 23, 476 P.2d 185, 190 (1970). However, contribution for the costs of

[11] Within the category of repairs and maintenance the bankruptcy court included expenditures for: draperies, carpet, vinyl, tub enclosures, water heaters, and appliances. The bankruptcy court found that these expenditures did not increase the market value of the real property.

repairs and maintenance is required, regardless of the existence of an agreement between the parties. Palmer, 476 P.2d at 189.

The bankruptcy court found that, during the time Dr. Hildreth maintained and repaired the properties, neither Deborah Cox, nor Dr. Hildreth were aware of Deborah Cox's one-half interest in the properties. As a result, Judge Higdon determined that equity excused Dr. Hildreth from the requirement that he request contribution prior to incurring expenses.

A judge sitting in equity may absolve a cotenant of the responsibility to request contribution for the costs of permanent repairs. Id. at 190. However, it is unnecessary to reach this question in this case. The bankruptcy court found that the expenditures made by Dr. Hildreth were necessary to preserve the rental quality of the properties. As such, Dr. Hildreth's expenditures are properly characterized as repair and maintenance costs. I find that as a cotenant with Dr. Hildreth, Deborah Cox and, therefore, the bankruptcy estate, "is required to bear [her] proportionate share of the expenses of maintaining and keeping the property in repair." Id. at 189.[12] The bankruptcy court was correct in allowing Dr. Hildreth an set-off for contribution against the bankruptcy estate.

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[12] The trustee asserts that Oregon law "will not force a cotenant to contribute to such remodeling expenses unless there is a corresponding improvement in the value of the property. Since there was no improvement to the value of the property, the Bankruptcy Court's ruling requiring contribution was improper." The trustee's argument misses the mark. The bankruptcy court found that the expenses incurred by Dr. Hildreth were for the costs of repair and maintenance of the properties. The court does not find, and the trustee does not charge that these findings are clearly erroneous.

2. The Assumption Agreements

On November 14, 1984, Dr. Hildreth executed two assumption agreements with the bank. At trial, the trustee argued that the assumption agreements and subsequent payments to the bank by Dr. Hildreth relieved Deborah Cox of her obligations to the bank under the land sale contract of February 21, 1984. The trustee argued under the theory of novation that, Deborah Cox's obligation to the bank was discharged, and neither she, nor the bankruptcy estate, were liable for a cotenant's proportionate share of the payments to service the debt made by Dr. Hildreth. The bankruptcy court held that the assumption agreements did not operate to discharge the either of the Coxes.[13]

To constitute a novation, all claims on the debts against the original debtor must be released. Whit-log v. Fibrex & Shipping Co., 90 Or.App. 237, 752 P.2d 843, 844 (1988). The parties must mutually and unequivocally relinquish their rights under the original contract. Puziss v. Geddes, 96 Or.App. 154, 771 P.2d 1028, 1030 (1989); Dorsey v. Tisby, 192 Or. 163, 234 P.2d 557 (1951).

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[13] Judge Higdon found: "The rights and obligations of the Coxes to the Bank which arose out of their execution of [the land sale contract] are not addressed in the assumption agreements. The Coxes did not sign the assumption agreements. A novation involves the substitution of a new debt or obligation for an existing one. If the document does not explicitly state the parties' intent that a novation take place then sufficient evidence must be presented to the court for it to conclude that the parties intended the agreement to represent a novation. The language of the assumption agreements contains nothing to indicate the parties intended it as a novation; nor did the plaintiff present sufficient evidence to support this theory."

In this case, the assumption agreements did not relinquish the bank's right to enforce Deborah Cox's obligation. The terms of the assumption agreements provide that in the event the conveyance by the Coxes to Dr. Hildreth becomes unenforceable, Dr. Hildreth's obligations under the assumption agreements cease. By the express terms of the assumption agreements, Dr. Hildreth's obligation under those agreements ceased when the conveyance of Deborah Cox's interest in the properties to Dr. Hildreth was determined to be unenforceable due to the forgery of her signature. Deborah Cox's original obligation to the bank was not extinguished by the assumption agreements.

The trustee also contends that section 7 of the land sale contracts operates, either independently or in conjunction with the language of the assumption agreements, to discharge the debtor's obligations to the bank.

Section 7 of the land sale contracts states that, if certain conditions are met, an assignment or transfer of the debtor's interest in the property relieves the debtors of their obligation under the contracts. In order to trigger section 7 of the land sale contracts there must be an assignment or transfer of the individual debtor's interest. Deborah Cox never assigned or transferred her interest in the property.

I find that Dr. Hildreth's actions in regard to the assumption agreements and the land sale contracts did not discharge Deborah Cox's obligation to the bank. It is therefore unnecessary to address the trustee's contention that the

bankruptcy court erred in ruling that even if the assumption agreements were a novation, equity would require contribution.

Conclusion

The bankruptcy court's order and judgment is AFFIRMED.

DATED this 19th day of December, 1990.

ROBERT E. JONES
United States District Judge

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