

11 U.S.C. § 542
11 U.S.C. § 550

Lansdowne v. Hildreth

Civil No. 90-6404-JO
Adversary No. 687-5053-H
Bankruptcy Case No. 684-
08450-H7

In re Cox

12/19/90

District Ct. (Judge Jones) affirming PSH

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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 § 547(e)(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.

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U.S. DISTRICT COURT, 12-20-90
DISTRICT OF OREGON
SOUTHERN DIVISION
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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON

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

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.

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

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

16 The properties were managed by Cox Property Management, a
17 property management company owned by the debtors. The tenants
18 residing in the apartment buildings on the properties were not
19 notified of the change in ownership from the debtors to Dr.
20 Hildreth. Cox Property Management managed the properties and
21 collected rent payments from February, 1984 through September,
22 1984. In late September, 1984, the debtors fled the state with
23 the assets of several investors, including several thousand
24 dollars which Dr. Hildreth had previously invested with the
25 debtors. In early October, 1984, Dr. Hildreth employed a new
26 property management company.

1 Between February 27, 1984, and the time of trial, April 25,
2 1989, the properties generated \$177,821.78 in rental income. The
3 rental income generated by the properties was used by Dr. Hildreth
4 to make payments to the bank on the debt owed to the bank and
5 secured by a lien on the properties. The rental income was also
6 applied to pay property taxes, pay repair and maintain costs of
7 the properties, and applied to insurance premiums and management
8 fees. Dr. Hildreth paid an additional \$15,015.87 of his own funds
9 for property taxes.

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

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

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

4 Subsequently, Dr. Hildreth moved the bankruptcy court to
5 amend its judgment. Dr. Hildreth's motion was granted and the
6 judgment was amended by a letter opinion granting Dr. Hildreth an
7 improvement lien under 11 U.S.C. § 550(d) in the amount of
8 \$155,953.69. This amount reflected Dr. Hildreth's expenditures
9 for property taxes, debt service to the bank, repair and
10 maintenance costs, and management fees. Accordingly, the trustee
11 was awarded the properties plus a money judgment of \$21,686.09
12 against Dr. Hildreth.

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

19 In the second amended order and judgment, the bankruptcy
20 court found that, under Oregon law, the Coxes had held the
21 properties as tenants by the entirety. Judge Higdon determined
22 that Deborah Cox's signature on the February 27, 1984 land sales
23 agreements between the Coxes and Dr. Hildreth was an unauthorized
24 forgery. Therefore, the transfer of the property to Dr. Hildreth
25 by Steven Cox with Deborah Cox's forged signature did not destroy
26

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

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

11 The claim under the 11 U.S.C. § 542 was plead in the
12 alternative and based on the same underlying facts as the
13 trustee's claim under 11 U.S.C. § 547. The bankruptcy court
14 determined that the trustee was limited to a single satisfaction
15 of either \$23,001.78 under the 11 U.S.C. § 547 claim, or
16 \$11,500.89 under the 11 U.S.C. § 542 claim.

17 Jurisdiction

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

19 Scope of Review

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

23 Discussion

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

1 A. The Section 547 Claim

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

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

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

16
17
18 2 Section 547(b) of the Code provides:

19 "Except as provided in subsection (c) of this section, the trustee may
20 avoid any transfer of an interest of the debtor in property--

21 (1) to or for the benefit of a creditor;

22 (2) for or on account of an antecedent debt owed by he debtor
23 before such transfer was made;

24 (3) made while the debtor was insolvent;

25 (4) made--

26 (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.

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

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

16 11 U.S.C. § 547(e) ²(1).

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

22 However, the definition of when a transfer is "made" for
23 purposes of determining whether the transfer was a preference 11
24 U.S.C. § 547 is expressly limited by subsection (e)(2) which
25 begins: "For purposes of this section . . . a transfer is made
26 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"

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

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

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

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

1 whom property has been recovered pursuant to section 550(a).
2 4 Collier on Bankruptcy, Para. 550.01 at 550-3.⁴

3 Several decisions imply that the transferee's good faith
4 status should be determined on the date of transfer as effective
5 between the parties, not the date when the transfer was "made"
6 under 11 U.S.C. § 547(e). See e.g., In re Brooklyn Overall Co.,
7 Inc., 57 B.R. 999, 1004 (Bankr. E.D. N.Y. 1985) (rights of
8 transferee are determined by looking to the time of assignment);
9 In re Black & White Cattle Co., 783 F.2d 1454, 1462 (9th Cir.
10 1986) (transferee's good faith determined by looking to the
11 evidence of parties' intent at the time of the parties'
12 agreement); In re Brown Iron and Metal, Inc., 28 B.R. 426, 430
13 (Bankr. E.D. Ten. 1983) (date transfer "made" for purposes of
14 section 548 not date used in determining date of improvements for
15 purposes of section 550(d)); see also 4 Collier on Bankruptcy,
16 Para. 550.03 at 550-110(with respect to pre-petition transfers
17 that are recoverable, court should ask whether transferee had
18 reasonable cause to believe that a petition would be filed).

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

22 ⁴ Section 550(d)(1) provides:

23 "A good faith transferee from whom the trustee may recover under subsection (a)
24 of this section has alien on the property recovered to secure the lessor of-

25 (A) the cost, to such transferee, of any improvement made after the
26 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."

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

10 A transferee's good faith status is determined on a case-
11 by-case basis. In re Blitstein, 105 B.R. 133, 137 (Bankr. S.D.
12 Fla. 1989). The court must determine if a reasonable person,
13 standing in the shoes of the transferee, knew or should have known
14 the transfer was motivated by a desire to defraud the debtor's
15 creditors. 4 Collier on Bankruptcy, Para. 550.02 at 550-9, n.
16 3; In re Robbins, 91 B.R. 879, 886 (Bankr. W.D. Mo. 1988).

17 The good faith provisions of 11 U.S.C. § 550 necessarily
18 require a factual determination. See e.g., Robbins, 91 B.R. at
19 886-87. It is unclear how the court could make a factual
20 determination if the court is required to look to the time fixed
21 by section 547(e), which in many cases may be several months or
22 years after the transfer has been effected between the parties.

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

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

4 The Code defines a transfer as "every mode, direct or
5 indirect, absolute or conditional, voluntary or involuntary, of
6 disposing of, or parting with property or with an interest in
7 property, including retention of title as a security interest and
8 foreclosure of the debtor's equity of redemption." 11 U.S.C. §
9 101(54). When Steven Cox and Dr. Hildreth executed the two sales
10 agreements on February 27, 1984, Steven Cox voluntarily parted
11 with his interest in the two apartment buildings. On that same
12 date, Deborah Cox parted, albeit involuntarily, with an interest
13 in the apartment buildings. The record supports the bankruptcy
14 court's finding that at the time the Coxes parted with their
15 interests in the properties, Dr. Hildreth did not know, and could
16 not have known, that the Coxes would later forsake their
17 obligations to their creditors.

18 I conclude that for purposes of 11 U.S.C. § 550(d), the
19 determination of whether a transferee acted in good faith must be
20 made by considering the circumstances as they existed at the time
21 of "transfer" as that term is defined in section 101(54). In this
22 case, that date was February 27, 1984. At the time of transfer,
23 Dr. Hildreth acted in good faith in dealing with the Coxes. The
24 bankruptcy court did not err in determining Dr. Hildreth's good
25 faith transferee status on February 27, 1984. Therefore, the
26

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

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

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

13 a. Rents are Property of the Estate

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

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

1 11 U.S.C. § 550(a). See In re Burke, 60 B.R. 665, 669-70 (Bankr.
2 D. Conn. 1986).⁵

3 b. Property Recovered Includes Rents

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

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

17
18 ⁵ This conclusion is supported by the reasoning of other bankruptcy
19 courts.

20 If, for example, a debtor transferred real property,
21 defined under Code § 547 as a preference, the trustee
22 could avoid the transfer and retrieve the property.
23 If during the preference period, the transferee
24 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.

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

26 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.

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

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

20 3. The Date of the Improvement Lien

21 The bankruptcy court found that Dr. Hildreth was entitled to
22 an improvement lien for expenditures made by Dr. Hildreth from the
23 date the sales agreements were executed, February 27, 1984. The
24 trustee contends the court erred in allowing an improvement lien
25 for expenditures made between the date the sales agreements were
26

1 executed and the date the transfer was "made" for under 11 U.S.C.
2 § 547(e).

3 As a good faith transferee, Dr. Hildreth "has a lien on the
4 property recovered to secure the lesser of-- (A) the cost, to such
5 transferee, of any improvement made after the transfer"
6 11 U.S.C. § 550(d)(1)(A) (emphasis added). As previously
7 discussed, for purposes of 11 U.S.C. § 550, a transfer takes place
8 when the debtor parts with an interest in property. See 11 U.S.C.
9 § 101(54). In this case, that date was February 27, 1984. The
10 bankruptcy court's determination of this issue was correct.

11 4. The Amount of the Improvement Lien

12 The amount of a good faith transferee's improvement lien is
13 determined under the formula set forth in 11 U.S.C. § 550(d)(1).
14 The amount of the lien is limited to: 1) the lesser of the cost,
15 to the transferee, of any improvement made after the transfer,
16 less the amount of any profit from the property recovered; and 2)
17 any increase in the value of the property recovered as result of
18 improvements made by the transferee to the property transferred.
19 11 U.S.C. § 550(d)(1). The Code defines improvements broadly to
20 include: 1) physical additions or changes, 2) repairs, 3) property
21 tax payments, 4) certain loan payments, and 5) preservation of the
22 property. 11 U.S.C. § 550(d)(2).

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

1 payment of property taxes is an improvement. 11 U.S.C. §
2 550(d)(2)(D). The bankruptcy court found that Dr. Hildreth made
3 physical additions or changes to the transferred property. Making
4 physical additions or changes is an improvement. 11 U.S.C. §
5 550(d)(2)(C). The bankruptcy court found that Dr. Hildreth made
6 repairs to the property transferred. Repairs are improvements.
7 11 U.S.C. § 550(d)(2)(B). Implicit in the bankruptcy court's
8 findings is that Dr. Hildreth made expenditures to preserve the
9 property. Preservation of transferred property is an improvement.
10 11 U.S.C. § 550(d)(2)(E). Finally, the bankruptcy court found
11 that Hildreth made payments on a debt secured by a lien on the
12 property transferred and that the lien was superior or equal to
13 the rights of the trustee. Payment on a debt secured by a lien
14 on the property transferred where the lien is equal to or superior
15 than the rights of the trustee is an improvement. 11 U.S.C. §
16 550(d)(2)(D).⁷

17 5. Increase in the Value of the Property Recovered

18 At trial, the bankruptcy court held that Dr. Hildreth's
19 improvement lien was limited by 11 U.S.C. § 550(d)(1)(B) to the
20 increase in the fair market value of the properties subsequent to
21 the transfer. Because the fair market value of the properties had
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23 ⁷ The trustee charges that Dr. Hildreth failed to carry his burden
24 of establishing that payments made to the bank were on a debt secured by a lien
25 on the property equal to the rights of the trustee or that the bankruptcy court
26 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.

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

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

11 As previously discussed, the trustee may recover the
12 "property transferred" and rents generated thereby. 11 U.S.C. §
13 550(a). A good faith transferee has a lien on the "property
14 recovered" to secure either the cost of the improvement less any
15 profit, or the increase in the value of "such property" as a
16 result of the improvements to the "property transferred." 11
17 U.S.C. § 550(d)(1). The term "such property" refers to the
18 property recovered by the trustee, not the property transferred
19 by the debtor.

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

1 increased by the expenditures made by Dr. Hildreth. The cost, to
2 Dr. Hildreth, of the improvements was \$154,820.00. The increase
3 in the value of the property recovered was \$177,821.78. The
4 lesser of these is the cost, to Dr. Hildreth, of the improvements.
5 Therefore, Dr. Hildreth has a lien on the property recovered to
6 secure \$154,820.00. 11 U.S.C. § 550(d)(1).

7 6. Payments to the Bank

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

15 In order for payments on a debt to qualify as an improvement
16 only two conditions need be met: 1) the debt must be secured by
17 a lien on the property transferred, not the property recovered⁸,
18 and 2) the lien must be superior or equal to the rights of the
19 trustee.⁹ 11 U.S.C. § 550(d)(2)(D). Both conditions are met in
20 this case.

21
22 ⁸ Under 11 U.S.C. § 550(d)(2)(A) "improvement" includes "changes to
23 the property transferred." Subparts (B) through (E) then refer to "such
24 property." Clearly, "such property" as used in subparts (B) through (E) refers
25 to the property transferred as used in subpart (A) not the property
26 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.

1 The trustee next asserts that at the time the case was
2 commenced the debt due to the bank was \$270,000, and that the
3 evidence indicates the value of the properties at that time was
4 only \$267,500, therefore, the bank's lien was under-secured by
5 \$2,500. The trustee argues that under 11 U.S.C. § 506 the bank's
6 lien is void and any amount paid on the debt cannot be considered
7 as payment against a secured claim.

8 Section 506(a) provides that an under-secured creditor has
9 a allowed secured claim only to the extent of the value of the
10 collateral, and has an unsecured claim for the balance. 11 U.S.C.
11 § 506(a). Section 506(d) provides that "[t]o the extent that
12 lien secures a claim against a debtor that is not an allowed
13 secured claim, such lien is void" 11 U.S.C. § 506(d).
14 In this case, the bank has a secured claim of \$267,500. The claim
15 is void only to the extent it is not a secured claim which is
16 \$2,500. 11 U.S.C. § 506(d). I find, therefore, that the bank's
17 lien was not void.

18 7. Dr. Hildreth's Motion

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

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

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

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

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

21 B. The Section 542 Claim

22 At trial, the trustee raised 11 U.S.C. § 542 as an
23 alternative theory of recovery.¹⁰ Section 542(a) requires, with
24 certain exceptions, that any person in possession of property of
25

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

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

13 1. Contribution

14 Under Oregon law, "[a] cotenant is required to bear a
15 proportionate share of the expenses of maintaining and keeping
16 property in repair and the cost of permanent improvements to which
17 she consents." Lesser v. Lesser, 79 Or.App. 738, 720 P.2d 405,
18 406 (1986). Contribution for the costs of permanent improvements
19 is required only where there has been "an express or implied
20 agreement to that effect or if there are equitable considerations
21 justifying contribution." Palmer v. Protroka, 257 Or. 23, 476
22 P.2d 185, 190 (1970). However, contribution for the costs of
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24

25 ¹¹ Within the category of repairs and maintenance the bankruptcy court
26 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.

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

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

9 A judge sitting in equity may absolve a cotenant of the
10 responsibility to request contribution for the costs of permanent
11 repairs. Id. at 190. However, it is unnecessary to reach this
12 question in this case. The bankruptcy court found that the
13 expenditures made by Dr. Hildreth were necessary to preserve the
14 rental quality of the properties. As such, Dr. Hildreth's
15 expenditures are properly characterized as repair and maintenance
16 costs. I find that as a cotenant with Dr. Hildreth, Deborah Cox
17 and, therefore, the bankruptcy estate, "is required to bear [her]
18 proportionate share of the expenses of maintaining and keeping the
19 property in repair." Id. at 189.¹² The bankruptcy court was
20 correct in allowing Dr. Hildreth an set-off for contribution
21 against the bankruptcy estate.

22
23 ¹² The trustee asserts that Oregon law "will not force a cotenant to
24 contribute to such remodeling expenses unless there is a corresponding
25 improvement in the value of the property. Since there was no improvement to
26 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.

1 2. The Assumption Agreements

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

13 To constitute a novation, all claims on the debts against the
14 original debtor must be released. Whit-log v. Fibrex & Shipping
15 Co., 90 Or.App. 237, 752 P.2d 843, 844 (1988). The parties must
16 mutually and unequivocally relinquish their rights under the
17 original contract. Puziss v. Geddes, 96 Or.App. 154, 771 P.2d
18 1028, 1030 (1989); Dorsey v. Tisby, 192 Or. 163, 234 P.2d 557
19 (1951).

20
21
22 ¹³ Judge Higdon found: "The rights and obligations of the Coxes to the
23 Bank which arose out of their execution of [the land sale contract] are not
24 addressed in the assumption agreements. The Coxes did not sign the assumption
25 agreements. A novation involves the substitution of a new debt or obligation
26 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."

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

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

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

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

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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