UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE
SOUTHERN DIVISION

In re:

TAPISTRON INTERNATIONAL, INC.

Debtor

Case No. 01-14159
Chapter 11

TAPISTRON INTERNATIONAL, INC.

Plaintiff

v.

Adversary Proceeding
No. 01-1208

RBI INTERNATIONAL, INC.

Defendant

MEMORANDUM

The parties have filed cross motions for summary judgment on the final two questions in this adversary proceeding. The first question is whether there was a preferential transfer when RBI simultaneously filed a termination statement and a financing statement as to the same item of collateral, machine 115.

The time stamps on the termination statement and the financing statement show that they were filed at exactly the same time, 12:00 p.m. on January 4, 2001. The clerk's office apparently stamped the financing statement first; its document number is one less than the termination statement's document number, 23-2000-1018 compared to 23-2001-1019. If the court attached any significance to the order in which the statements were stamped, as shown by the document numbers, the following reasoning might be applied:

> RBI's security interest was perfected by the filing of a financing statement in August 2000. That financing statement was terminated by the filing of the termination statement on January 4, 2001. Before that event, however, the security interest was perfected again by the filing of another financing statement. The termination statement did not affect the later financing statement because the termination statement identified only the earlier financing statement as the one that was terminated. Thus, filing the termination statement did not cause a break in perfection of RBI's security interest in machine 115. The continuous perfection of RBI's security interest in machine 115 means that the filing of the second financing statement, even if it was a transfer, could not have preferred RBI over Tapistron's unsecured creditors.

The court declines, however, to base its decision on the order in which the clerk's office stamped the financing statement and the termination statement. The time stamps show they were filed at the same time, and the court will treat them as filed at the same time.

The trustee's argument breaks the transaction down into component parts to show that all the elements of a preferential transfer exist. 11 U.S.C. § 547(b). Judge Keith Lundin dealt with essentially the same problem in the *Biggers* case. *Gregory v. Community Credit Co. (In re Biggers)*, 249 B.R. 873 (Bankr. M. D. Tenn. 2000). That case involved refinancing. Cityside financed the debtors' purchase of a pickup truck and took a security interest in the truck to secure the debt. Cityside perfected the security interest by having it noted on the truck's certificate of title. Cityside then merged with the defendant, CCC. The debtors refinanced with CCC. CCC sent the Department of Motor Vehicles an application for a new certificate of title with its security interest noted *and* a release of the original security interest. Judge Lundin held that there was a transfer, but it was not avoidable as a preference. Judge Lundin said:

> Looking only at the "trees" and parsing each component of the refinancing, it is easy to conclude that the transfer allowed CCC to receive more than it would receive in a Chapter 7 case. CCC

> released the original (Cityside) lien on the pickup. CCC took a new note and received a new security interest. But for the new security interest, CCC would have been an unsecured creditor in a case under Chapter 7. Viewed in this narrow light, perfection of the new lien enabled CCC to realize a greater share of the [bankruptcy] estate.

Biggers, 249 B.R. 873, 877.

Judge Lundin went on to say that the courts generally have not adopted this reasoning. Instead, the courts have considered the overall effect of the transaction, and on that basis, they have concluded that it does not involve an avoidable preferential transfer. The courts have not been consistent in their reasoning, but it boils down to one point: the transaction as a whole did not improve the secured creditor's position at the expense of other creditors. *Biggers*, 249 B.R. 873, 877–879. Judge Lundin concluded that "CCC documented the refinancing of the debtor's pickup in a manner that created the technical elements of a preference, but without preferential effect." *Biggers*, 249 B.R. 873, 879.

The situation in this case is the same. The transaction did not create any time when machine 115 was not subject to RBI's perfected security interest. The transaction did not take away from Tapistron's unsecured creditors any equity in machine 115 that might have been available for payment of their claims. In summary, the transaction did not improve RBI's position to the detriment of Tapistron's other creditors. There was no avoidable preferential transfer of a security interest in machine 115 when RBI simultaneously filed the termination statement and financing statement. *Gregory v. Community Credit Co. (In re Biggers)*, 249 B.R. 873 (Bankr. M. D. Tenn. 2000); *see also Waldschmidt v. Mid-State Homes, Inc. (In re Pitman)*, 843 F.2d 235, 241-242 (6th Cir. 1988).

It follows that when Tapistron filed bankruptcy, RBI had an unavoidable security interest in machine 115 to secure the $50,000 note. Likewise, RBI had an allowed secured claim

in Tapistron's bankruptcy case to the extent the value of machine 115 is sufficient to pay the balance due on the $50,000 note. 11 U.S.C. § 506(a).

This brings up the second question dealt with by the summary judgment motions. What is the balance due on the $50,000 note? In particular, what was the effect of Tapistron's $25,000 payment to RBI in early October 2000?

The trustee concedes that he can not recover the $25,000 payment as a preferential transfer because Tapistron was solvent at the time of the payment. 11 U.S.C. § 547(b)(3). The court's previous decisions have divided RBI's claims into a $50,000 secured claim, and a $200,000 unsecured claim. The question is how the $25,000 payment should be divided among these two claims.

The trustee will retain the proceeds from the sale of machine 115 after paying RBI's allowed secured claim. The proceeds retained by the bankruptcy trustee will be available to pay priority and unsecured claims in Tapistron's bankruptcy case. In bankruptcy jargon, the trustee will retain the balance of the proceeds for the benefit of the bankruptcy estate.

If the court applies the $25,000 payment entirely to the $50,000 note, that will produce the maximum benefit for the bankruptcy estate because it will produce the smallest balance due on the $50,000 note. If the court applies the $25,000 payment entirely to the $200,000 debt, that will produce the maximum benefit for RBI and the smallest benefit for the bankruptcy estate. The court might also apply the payment proportionally: $20,000 (80%) on the $200,000 note and $5,000 (20%) on the $50,000 note. This would produce almost as great a benefit for RBI, and as small a benefit for the bankruptcy estate, as applying the payment entirely to the $200,000 unsecured note. The parties agree that the transactions between them are

governed by Georgia law, including Georgia law on applying payments when there are multiple debts. Georgia law includes a statute on the subject. It provides:

> When a payment is made by a debtor to a creditor holding several demands against him, the debtor shall have the right to direct the claim to which it shall be appropriated. If the debtor fails to do so, the creditor shall have the right to appropriate the payment at his election. If neither party exercises the privilege, the law shall direct the application in such manner as shall be reasonable and equitable, both as to the parties and third persons, provided that, as a general rule, the oldest lien and the oldest item in an account shall be paid first, the presumption of law being that such is the intention of the parties.

Ga. Code Ann. § 13-4-42.

The general rule stated at the end of this statute calls for applying the payment entirely to the oldest lien or debt. This is only a general rule, however; it does not prevent the judge or the jury from following the statute's primary command – to apply the payment in a manner that is reasonable and equitable as to the debtor, the creditor, and third parties. In summary, the statute does not require the court to apply the payment entirely to the $50,000 note as the oldest lien or debt. The court can apply the payment in a different manner if that will be reasonable and equitable for RBI, Tapistron, and third parties. *Killorin v. Bacon*, 57 Ga. 497 (1876); *J. M. High Co. v. Arrington*, 45 Ga.App. 392, 165 S.E. 151 (1932).

In this case, however, applying the $25,000 payment entirely to the $50,000 secured note is a reasonable and equitable result. The interested third party is the bankruptcy estate. The more money the trustee can retain for the bankruptcy estate, the more he will have available to pay unsecured and priority claimants. Applying the payment entirely to the $50,000 secured debt will result in the greatest benefit to the bankruptcy estate and the least benefit to RBI. As to RBI, it failed to take the correct legal steps to secure the additional $200,000 debt.

Dividing the payment according to one of the other methods will partially relieve RBI from the effect of its mistake at the expense of Tapistron's other creditors. That is not a reasonable and equitable result. *Austin v. Southern Home Building & Loan Assoc.*, 122 Ga. 439, 50 S.E. 382 (1905). Furthermore, the bankruptcy trustee as the representative of the bankruptcy estate may be likened to the holder of a lien on machine 115 for its benefit. 11 U.S.C. § 544(a)(1), (2). The court should not allow RBI to apply the proceeds from the machine's sale first to the $200,000 unsecured debt because that will reduce the amount the trustee will receive. *Cofer v. Benson*, 92 Ga. 793, 19 S.E. 56 (1894); *Farmers' and Merchants' Bank v. Reeves*, 20 Ga.App. 219, 92 S.E. 971 (1917). For these reasons, the $25,000 payment should be applied entirely to the $50,000 secured note.

The trustee's brief states that RBI has already received a payment from the sale proceeds, and the court's decision to apply the $25,000 payment entirely to the $50,000 note means that RBI has been overpaid by $2,928.77. The trustee shall submit an order in accordance with this memorandum.

This Memorandum constitutes findings of fact and conclusions of law as required by *Fed. R. Bankr. P.* 7052.

ENTER.

BY THE COURT

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HONORABLE R. THOMAS STINNETT
UNITED STATES BANKRUPTCY JUDGE

Entered 2/9/04