IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF MISSISSIPPI

IN RE:
FRED H. RENFROE AND
MATTIE J. RENFROE

CASE NO. 9700137
Chapter 13

HAROLD J. BARKLEY, TRUSTEE — **PLAINTIFF**

VS. — **ADVERSARY NO. 9700109JEE**

DISCOVER CARD/NOVUS FINANCIAL
AND FIRST FAMILY FINANCIAL SERVICES — **DEFENDANTS**

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MEMORANDUM OPINION

This adversary proceeding is before the Court on the *Motions for Summary Judgment* filed by Discover Card/Novus Financial ("Discover") and First Family Financial Services ("First Family"). Because these motions involve the same factual and legal issues, the Court will address both motions in this Memorandum Opinion. After considering the motions, the memorandum briefs in support of the motions, and the Trustee's response thereto along with the other pleadings filed in

this adversary proceeding, the Court holds that there exist genuine issues of material fact and that the motions of Discover and First Family for summary judgment should be denied. In so holding, the Court makes the following findings of fact and conclusions of law.

FINDINGS OF FACT

Fred H. Renfroe and Mattie J. Renfroe ("Debtors") filed a Chapter 13 bankruptcy petition on January 9, 1997. Prior to filing their bankruptcy petition, the Debtors applied for a loan with Norwest Financial ("Norwest"). The Debtors sought to pay certain of their creditors with the proceeds from this loan. Debtors listed several creditors, including Discover and First Family, on a portion of a loan statement entitled, "Amounts Paid to Others on Your Behalf." After the loan was approved, Norwest forwarded checks to both Discover and First Family in the amounts listed in the Debtors' loan statement, $1,954.34 to Discover and $2,447.03 to First Family. These checks were made payable to the creditors only and not made jointly payable to the Debtors.

After filing bankruptcy, the Chapter 13 Trustee filed a *Complaint to Avoid Preferential Transfers* in which he argued that the two transfers to Discover and First Family were for or on account of an antecedent debt, made while the Debtors were insolvent, made less than 90 days before the Debtors filed bankruptcy, and that such payments entitled Discover and First Family to receive more than they would receive if the bankruptcy case were a Chapter 7 case and the transfer had not been made. Discover and First Family each filed a *Motion for Summary Judgment*. Both contend that the Debtors did not transfer an interest in property; thus, no voidable preference was created.

CONCLUSIONS OF LAW

I.

This Court has jurisdiction of the subject matter and of the parties to this proceeding pursuant to 28 U.S.C. § 1334 and 28 U.S.C. § 157. This is a core proceeding as defined by 28 U.S.C. 157(b)(2)(F).

II.

Rule 56 of the Federal Rules of Civil Procedure as made applicable by Rule 7056(e) of the Federal Rules of Bankruptcy Procedure provides that in order for a court to sustain a motion for summary judgment, the court must find that "[t]he pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." See also Celotex Corp. v. Catrett, 477 U.S. 317, 322-34, 106 S.Ct. 2548, 2552-58, 91 L.Ed.2d 265 (1986). Additionally, the court must view the available evidence in the light most favorable to the nonmoving party. Matsushita Electric Industrial Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 587-88, 106 S.Ct. 1348, 1356-57, 89 L.Ed.2d 538, 553 (1986).

11 U.S.C. § 547(b)[1] allows a bankruptcy trustee to avoid preferential transfers of a debtor's property made prior to the commencement of a bankruptcy case. Section 547(b) provides as follows:

> (b) 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,

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[1] Hereinafter, all code sections refer to the Bankruptcy Code found at Title 11 of the United States Code unless specifically noted otherwise.

> (2) for or on account of an antecedent debt owed by the 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;
>
> (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.

Id. The underlying purpose for allowing transfers to be voided is to "facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor. Any creditor that received a greater payment than others of his class is required to disgorge so that all may share equally." Coral Petroleum, Inc. v. Banque Paribas-London, 797 F.2d 1351, 1355 (5th Cir. 1986). See also Cullen Center Bank & Trust v. Hensley, 102 F.3d 1411, 1414 (5th Cir. 1997); Lawrence P. King, ed., 4 Collier on Bankruptcy, ¶ 547.01, at 547-12 (15th edition 1996)(hereinafter referred to as "Collier").

Both Discover and First Family rely on the "earmarking doctrine", a judicially created concept, because they contend that the Debtors never transferred an interest in the property so that the estate was diminished. The Fifth Circuit Court of Appeals described the earmarking doctrine as follows:

> If all that occurs in a "transfer" is the substitution of one creditor for another, no preference is created because the debtor has not transferred property of his estate; he still owes the same sum to a creditor, only the identity of the creditor has changed. This type of transaction is referred to as "earmarking," and is, according to a noted bankruptcy treatise, applicable in the following circumstances:

> "In cases where a third person makes a loan to a debtor specifically to enable him to satisfy the claim of a designated creditor, the proceeds never become part of the debtor's assets, and therefore no preference is created. The rule is the same regardless of whether the proceeds of the loan are transferred directly by the lender to the creditor or are paid to the debtor with the understanding that they will be paid to the creditor in satisfaction of his claim, so long as such proceeds are clearly 'earmarked.' "

Coral, 797 F.2d at 1356 (quoting Collier, at ¶ 547.25 at 547-101-02). The earmarking doctrine was originally adopted in the scenario when a guarantor of a debtor agrees to loan the debtor funds to repay a loan guaranteed by the guarantor. See McCuskey v. National Bank of Waterloo (In re Bohlen), 859 F.2d 561, 565 (8th Cir. 1988). The rationale was that if the payment was avoided as a preference, the guarantor would have to repay the loan twice because the money would be returned to the bankruptcy estate and not the guarantor.

The earmarking doctrine was expanded to apply to the scenario where a "subsequent loan was made on the condition that it be used to repay an existing loan." Yoppolo v. Greenwood Trust Co. (In re Spitler), 213 B.R. 995, 998 (N.D. Ohio 1997). In those instances, the "determinative issue . . . became whether the debtor exercised dominion and control over the loan proceeds." Id. At issue in Spitler was the amount of dominion and control exercised by the debtor over loan proceeds used to pay an existing debt. In Spitler, the debtor made payment on an existing credit card debt with a convenience check from another credit card account. The trustee argued that the payment was a preferential transfer. The Court found that the debtor had dominion and control over the use of the new loan proceeds because he could have used the proceeds to pay any number of creditors or kept

the money for himself. Therefore, the Spitler court found that the earmarking doctrine was inapplicable and that the payment was a preferential transfer.

The same result was reached by the court in Rafool v. Citizens Equity Federal Credit Union (In re Hurt), 202 B.R. 611 (Bankr. Ill. 1996). In Hurt, the debtor used "balance transfer checks" to pay an existing debt, an act the trustee argued was a preferential transfer. The Hurt court agreed, finding that the available funds were not designated by the new lender to be used to pay off certain creditors, but that the debtor made the choice to pay off certain creditors and not others.

The trustee in the instant case contends that the Debtors exercised some discretion and control over the proceeds of the Norwest loan because they were able to choose which creditors were paid with the Norwest funds. The Debtors listed certain creditors, including Discover and First Family, on a portion of a loan statement entitled, "Amounts Paid to Others on Your Behalf." Although Norwest forwarded checks directly to Discover and First Family and not to the Debtors, there exist questions of fact as to whether the Debtors exercised some control in selecting which creditors were to be paid with the Norwest loan proceeds and whether the Debtors could have received the money from Norwest for their own personal use.

Based on the foregoing, the Court concludes that the *Motions for Summary Judgment* are not well taken and should be denied. The Court will enter a separate order consistent with this opinion.

THIS the 1st day of May, 1998.

UNITED STATES BANKRUPTCY JUDGE

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DISCOVER CARD/NOVUS FINANCIAL
AND FIRST FAMILY FINANCIAL SERVICES **DEFENDANTS**

ORDER

This matter came before the Court on the *Motions for Summary Judgment* filed by Discover Card/Novus Financial and First Family Financial Services. After considering the motions, the memorandum briefs in support of the motions and the Trustee's response thereto along with the other pleadings filed in this adversary proceeding, the Court finds that there exist genuine issues of material fact which preclude the Court from granting summary judgment.

Therefore, the *Motions for Summary Judgment* filed by Discover Card/Novus Financial and First Family Financial Services are hereby denied.

ORDERED this the 1st day of May, 1998.

UNITED STATES BANKRUPTCY JUDGE