

**UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK**

In re:

**VARGESON, CLAYTON S. and
VARGESON, ANN M.,**

Debtors.

CASE NO. 99-21163

DECISION & ORDER

PETER SCRIBNER, TRUSTEE,

Plaintiffs,

V.

AP #99-2282

**SOURCE ONE MORTGAGE SERVICES
CORPORATION,**

Defendants.

BACKGROUND

On April 19, 1999, Clayton S. Vargeson and Ann M. Vargeson (the “Debtors”) filed a petition initiating a Chapter 7 case. On the Schedules and Statements required to be filed by Section 521 and Rule 1007, the Debtors indicated that they owned a residence at 6 Goodhue Street, Addison, New York (the “Residence”) which was subject to a recorded first mortgage in favor of Source One Mortgage Services Corporation (“Source One”).

On September 21, 1999, the Debtor’s Trustee (the “Trustee”) commenced an Adversary Proceeding (the “Avoidance Proceeding”) against Source One which requested that the Court determine that the transfer which occurred when Source One recorded its mortgage on the Residence was an avoidable preferential transfer. The Trustee’s Complaint in the Avoidance Proceeding alleged that: (1) on or about July 24, 1998, the Debtors refinanced an existing mortgage on the Residence with Island Mortgage Network (“Island Mortgage”); (2) at the time of the refinance, the

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Debtors executed and delivered a promissory note and a mortgage in favor of Island Mortgage which were immediately assigned to Source One (the "Assignment"); (3) it was not until April 13, 1999, more than eight months later and within 90 days of the filing of the Debtor's petition, that the Assignment and the mortgage (the "Source One Mortgage") were recorded in the Steuben County Clerk's Office; (4) the transfer which occurred when the Source One Mortgage was recorded was avoidable pursuant to Section 547(b)¹.

¹ Section 547 provides, in part:

(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;

(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; 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.

(c) The trustee may not avoid under this section a transfer—

(1) to the extent that such transfer was—

(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and

(B) in fact a substantially contemporaneous exchange;

(2) to the extent that such transfer was—

(A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee; and

(B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and

(C) made according to ordinary business terms;

(3) that creates a security interest in property acquired by the debtor—

(A) to the extent such security interest secures new value that was—

(i) given at or after the signing of a security agreement that contains a description of such property as collateral;

(ii) given by or on behalf of the secured party under such agreement;

(iii) given to enable the debtor to acquire such property; and

(iv) in fact used by the debtor to acquire such property; and

(B) that is perfected on or before 20 days after the debtor receives possession of such property[.]

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Source One interposed an Answer to the Complaint which asserted that the transfer should not be avoided because: (1) the recording of the Source One Mortgage, which perfected the lien and security interest granted by the Mortgage, was a transfer made in the ordinary course of business, and, therefore, it was excepted by Section 547(c)(2); and (2) Source One was a good faith transferee without knowledge of the avoidability of the transfer, and, therefore, it was excepted by Section 550(b).

After a pretrial conference, the Trustee filed a Motion for Summary Judgment (the “Motion for Summary Judgment”). The Motion set forth the same allegations as contained in the Trustee’s Complaint, and further asserted that, since the Answer interposed by Source One raised no factual issues, the Court could rule on the avoidability of the transfer as a matter of law.

Source One interposed Opposition to the Motion for Summary Judgment which asserted that: (1) the Debtors granting of the Source One Mortgage and its subsequent recording fell within the contemporaneous exchange exception set forth in Section 547(c)(1) because the Mortgage was a contemporaneous exchange for new value in that it was granted on the same day that the Debtors received the refinancing proceeds and executed the promissory note and Source One Mortgage; (2) the bankruptcy estate should not receive a windfall at the expense of Source One, since if the Debtor’s original mortgage had not been refinanced on July 24, 1998, the Residence would be subject to the unavoidable lien of that original mortgage; and (3) because the Source One Mortgage was not a purchase money mortgage, the exception set forth in Section 547(c)(3) was not applicable.

At oral argument on the Motion for Summary Judgment, the attorneys for Source One argued primarily that: (1) the granting and recording of the Source One Mortgage when taken together

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constituted a single contemporaneous exchange for new value; (2) the recording of the Mortgage was in the ordinary course of business; and (3) Source One should be equitably subrogated to the rights of the holder of the previously perfected and unavoidable original mortgage on the Residence which was refinanced. At oral argument, the attorneys also acknowledged to the Court that they had submitted no published decisions based upon similar facts and circumstances which would support any of the Source One defenses.

DISCUSSION

I Contemporaneous Exchange - Section 547(c)(1)

_____ Source One, in its Opposition to the Motion for Summary Judgment and the causes of action set forth in the Complaint in the Avoidance Proceeding, has never contested that the recording of the Source One Mortgage more than eight months after it was executed and delivered was an avoidable preferential transfer in that all of the necessary elements of Section 547(b) were present. Source One has only raised affirmative defenses under Section 547(c) and the defense of subrogation.

Although in its Opposition to the Motion for Summary Judgment Source One has asserted that the Court should view the granting and recording of the Source One Mortgage as if it were one transfer, in fact, the granting of the Mortgage by the Debtors and the recording and perfection of the Mortgage are two separate transfers for purposes of Section 547. See *In re Alexander*, 219 B.R. 255, 259 (Bankr. D. Minn. 1998) (“*Alexander*”). In her Decision in *Alexander*, Bankruptcy Judge Nancy C. Dreher discussed in detail the conflicting case law on whether the recording of a mortgage on real

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estate outside the ten-day period provided for by Section 547(e)(2)² is a contemporaneous exchange for new value under Section 547(c)(1).³ In *Alexander*, Judge Dreher concluded that the transfer which occurs when a mortgage is recorded outside the 10-day time period provided for by Section 547(e)(2), is not a contemporaneous exchange for new value, and thus is an avoidable preferential transfer. I agree with Judge Dreher's reasoning in *Alexander*, adopt it, and hold that the recording of the Source One Mortgage, which was not a purchase money mortgage, more than eight months after it was executed and delivered, and thus outside the ten-day period provided for by Section 547(e)(2), was not a contemporaneous exchange for new value. Therefore, the affirmative defense set forth in Section 547(c)(1) is not available to Source One.

² Section 547(e)(2) provides that:

(2) For the purposes of this section, except as provided in paragraph (3) of this subsection, a 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, except as provided in subsection (c)(3)(B);

(B) at the time such transfer is perfected, if such transfer is perfected after such 10 days[.]

11 U.S.C. § 547(e)(2) (2000).

³ Even under the flexible case-by-case analysis test of *Pine Top Insurance Co. v. Bank of America National Trust Savings Ass'n*, 969 F.2d 32 (7th Cir. 1992), the recording of the Source One Mortgage would not be a “substantially contemporaneous” exchange.

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II Ordinary Course of Business - Section 547(c)(2)

The recipient of an avoidable preferential transfer that raises an ordinary course of business affirmative defense pursuant to Section 547(c)(2) bears the burden of proving each of the three required elements by a preponderance of the evidence. See *In re Roblin Industries*, 78 F.3d 30, 39 (2nd Cir. 1996). At no time in the Avoidance Proceeding has Source One even attempted to provide any evidence that: (1) it is in the ordinary course of business for Source One to record a mortgage executed and delivered in connection with a refinance more than eight months after the closing of the refinance; or (2) it is in the ordinary course of business of other mortgagees in the industry to record such mortgages more than eight months after they were executed and delivered and the refinancing proceeds disbursed. Therefore, Source One has not met its burden to establish an affirmative defense pursuant to Section 547(c)(2).

III Equitable Subrogation

Other than to assert that the Debtor's bankruptcy estate would be unjustly enriched if the transfer that occurred when the Source One Mortgage was perfected by recording more than eight months after it was executed and delivered is avoided, which is an argument made in every case where a lien is perfected to secure an antecedent debt within the preference period but outside the time periods provided for by Sections 547(c)(3) and 547(e)(2), Source One has not set forth any facts or circumstances which demonstrate that there was any fraud or mistake which the Debtors or Island Mortgage participated in which resulted in Source One failing to timely record its Mortgage. On the other hand, many courts have refused to apply the doctrine of equitable subrogation where a refinancing mortgagee, such as Source One, has required that: (1) the mortgagor execute and deliver

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a new mortgage, rather than to rely upon and take an assignment of the mortgage being refinanced; and (2) specifically required that the mortgage being refinanced be discharged of record as part of the refinancing closing. See *In re Bridge*, 18 F.3d 195 (3rd Cir. 1994); *In re Pearce*, 234 B.R. 261 (Bankr. S.D. Ill. 1999); and *In re Muller*, 185 B.R. 552 (Bankr. M.D. Tenn. 1995).

In this case, Island Mortgage and Source One never intended to take an assignment of or be subrogated to the rights of the prior mortgagee whose mortgage was being refinanced, but clearly intended to rely upon their own documents and the recording of the Source One Mortgage to provide a perfected lien on the Residence.

Because there was no fraud or mistake involved, and no intent by Source One or its assignor, Island Mortgage, to be subrogated to the rights of the mortgage which was refinanced, there is no basis for the Court to exercise its discretion to apply the doctrine of equitable subrogation. There are simply no equities which run in favor of Source One, a sophisticated commercial mortgagee that simply failed to record the Source One Mortgage for over eight months after the refinancing closing.

IV Good Faith Transferee For Value - Section 550(b)

Source One is a sophisticated mortgage lender that is aware of all of the potential legal and practical problems which can occur when a mortgage is not recorded immediately after a closing, especially when the mortgage is given in connection with the refinance of an existing mortgage that has been discharged as part of the closing. These potential problems include the possibility that the recording of the mortgage may be determined to be an avoidable preferential transfer if the mortgagors file bankruptcy shortly after the mortgage is recorded. Therefore, Source One is not a good faith transferee without knowledge as contemplated by Section 550(b).

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CONCLUSION

The lien of the Source One Mortgage on the Residence is avoided pursuant to Sections 547(b) and 550. Source One shall deliver to the Trustee within twenty (20) days of the date of this Decision & Order a Discharge of the Source One Mortgage in recordable form.

IT IS SO ORDERED.

_____/s/_____
HON. JOHN C. NINFO, II
CHIEF U.S. BANKRUPTCY JUDGE

Dated: March 21, 2000