

MAY 22 1996

J. BARON GROSHON
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Deputy Clerk

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NORTH CAROLINA

In Re:

DAN LAMBDIN COMPANY

Debtor.

Case No. 92-31990
Chapter 7

**DANIEL A. LAMBDIN and
JILL B. LAMBDIN**

Debtors.

JUDGEMENT ENTERED ON MAY 22 1996

**WAYNE SIGMON, Trustee in Bankruptcy
for DAN LAMBDIN COMPANY, DANIEL A.
LAMBDIN, and JILL B. LAMBDIN,**

Plaintiffs,

Adversary Proceeding
No. 94-3330

v.

NAGARBHAI NARSINHBHAI PATEL

Defendant.

ORDER

This Matter is before the court on the Trustee's Complaint To Recover Transfers filed October 26, 1994. After a hearing held on May 1, 1996, and further consideration of the issue, the court has concluded that the transfer at issue was a preferential transfer under §547 and the Trustee should recover judgment on his Complaint. The court makes the following Findings of Fact and Conclusions of Law and enters its Order:

1. On November 4, 1992, Daniel A. and Jill B. Lambdin filed a petition under Chapter 7 of the Bankruptcy Code.

2. On November 6, 1992, the Dan Lambdin Company filed a petition under Chapter 7 of the Bankruptcy Code.

3. By Order of the court dated March 9, 1994, the two cases were substantively consolidated. Wayne Sigmon is the Chapter 7 Trustee in the consolidated cases.

4. The Trustee filed a Complaint to Recover Transfers alleging that certain transfers of property made by the debtors were avoidable under §547 as preferences.

5. The defendant filed an Answer claiming that the transfers were not avoidable under §547 because the property transferred was not property of the debtor, but was, in fact, a return to the defendant of his own property.

6. On May 1, 1996, the parties entered a Stipulation of Facts which the court adopts herein as its Findings of Fact. A short summary of the facts is given below.

7. The Stipulation of Facts recites that the defendant executed an Offer to Purchase and Contract ("the Contract") with the Dan Lambdin Company. The purpose of the Contract was for the purchase of a parcel of land, upon which the Lambdin Company was to construct a house for defendant. The Contract specified that the defendant would pay \$13,660.00 as a binder at the time of approval of the Contract, with an additional \$13,660.00 paid at the start of construction, the remainder being due at closing,

which closing was to occur 150 days from loan approval (in order to enable the Lambdin Company to construct the house on the lot).

8. In section #3 of the Contract, "Purchase Price", the Contract contained the following language

The purchase price is \$273,000 and shall be paid as follows: \$13,660.00 in earnest money paid by personal check (includes \$1,000. lot binder check), \$13,660.00 due at the start of construction to be held by Allen Tate Company as agent, until the sale is closed. (emphasis added)

The escrow language highlighted above had been struck through and initialled by the parties. The Contract also contained a provision stating "it is understood that if the buyer cannot receive financing for the home then the above \$13,660.00 will be refunded to the buyer".

9. The Contract was delivered to the Allen Tate Company, along with a \$1,000.00 check drawn from the defendant's bank account and payable to the Allen Tate Company. Subsequently, a second check, in the amount of \$13,000.00 and dated March 18, 1992, payable to the Allen Tate Realtor Company Escrow, was delivered to the Allen Tate Company.

10. The Contract was accepted by the Lambdin Company on March 30, 1992.

11. Concurrently with the deposit of the \$13,000.00 to the Allen Tate Realty Company Escrow on March 18, 1992, a Lot Reservation was entered wherein the defendant agreed to pay an additional sum of \$13,000.00. The Lot Reservation provided:

In the event the Contract is not accepted, said deposit will be immediately refunded. If the Contract is

accepted, said deposit will apply towards 5% deposit required at contract. Deposit will be held in escrow with the Allen Tate Company till the contract is accepted at such time the 5% deposit money will go to the Dan Lambdin Company.

12. The Contract was executed and the defendant paid an additional \$13,320.00 deposit for earnest money on May 18, 1992.

13. On August 24, 1992, after the defendant and the Lambdin Company failed to get approved financing at the same bank, Mr. Lambdin sent a letter to the defendant stating that the contract was canceled due to lack of financing on both parts.

14. On August 24, a letter was sent from Dan Lambdin to the defendant agreeing to return the "earnest money" deposit. On August 28, 1992 the first deposit in the amount of \$13,660.00 was returned to the defendant. On September 9, 1992, a second letter referring to the return of "earnest money" was sent, including two checks in the amount of \$13,660.00 to the defendant.

15. At no time did the Lambdin Company begin construction of the house pursuant to the Contract. Lambdin Company filed its bankruptcy petition on November 6, 1992, within 90 days of the payments to the defendant.

16. Section 547 of the Bankruptcy Code provides that:

(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 the 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;

. . . .

(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 provision of this title.

17. The parties stipulated that parts (3), (4) and (5) of §547 were met.

18. The issue before the court is whether the deposit money held by the Lambdin Company was property of the debtor and therefore subject to §547, as the Trustee contends; or, as defendant contends, the deposit money remained property of the defendant and was only held by the Lambdin Company, for the defendant, in trust or otherwise.

19. The trustee argues that under Wayne Sigmon v. Royal Cake Company, Inc. (In Re: Cybermech, Incorporated), 13 F.3d 818 (4th Cir. 1994), the deposit money is property of the debtor and subject to §547. The trustee bases his argument on three points: (1) The "escrow requirement" language in the Contract was specifically marked out, and therefore the money was not held by a third party agent, but instead held by the Lambdin Company as its sole property. (2) Since the deposit money received was commingled in the Lambdin Company's general operating account instead of a separate escrow account, the money became the property of the debtor. (3) An "earnest money" deposit is a payment on the contract and therefore subject to a preference action.

20. The defendant argues that the earnest money deposit is just that: a deposit, not a payment on the contract. Therefore,

the money never became the property of the Lambdin company, but instead, was only held by the Lambdin Company. Since a condition of the contract was construction of the house and construction never took place, the contract was never fulfilled and the Lambdin Company never became entitled to the money.

21. In *Royal Cake*, the Fourth Circuit held that a debtor-seller corporation's return of a buyer corporation's down payment on a contract for the purchase of machines constituted a preferential transfer. *Id.* at 820-21. The defendant in *Royal Cake* argued that the payment was not a "transfer of an interest of the debtor in property" because the plaintiff did not have a property interest in that money. Instead, the defendant argued, the money was held in trust for the defendant and therefore, under §541(b)-(1) was not property of the estate. However, the Court found that the down payment was "not mere 'collateral' or a 'deposit,' but rather was [the defendant's] first payment for the machines. By sending the payment check, [the defendant] was fulfilling its obligation under the sales contract, not merely guaranteeing future performance of its payment obligations." *Id.* at 820. It therefore held that the money was property of the debtor.

The Court further found support for treating the money as property of the debtor because the money had been deposited into the debtor's account and was available for the unfettered use by the seller corporation. The Court stated "[O]nce [the plaintiff] deposited [the defendant's] check into its account, commingling the money with its other funds, [the plaintiff] had a right to

withdraw, transfer, or otherwise use the payment funds in any way it wanted. Id. at 820. This fact helped the Court distinguish another case cited by the defendant. That case, Rose's Stores, Inc. v Boyles, 416 S.E.2d 200 (N.C. Ct. App. 1992), review granted, 421 S.E.2d 356 (N.C. 1992), held that even though the money was commingled, the seller store had an agreement with the buyers that layaway advance payments would be returned to the buyers if they decided not to make the purchase. The store did not have the "right to withdraw, transfer, or otherwise use the payment funds in any way it wanted". Instead, the store was merely holding the money until the buyers agreed to the contract. In contrast, under the facts of Royal Cake, the corporations had no agreement as to refunding of the down payment in case of breach of the contract, so free use of the money was allowed.

The Royal Cake Court also held that the transfer at issue met the requirements of §547 because the transfer was made for the benefit of a "creditor", and on account of an "antecedent debt". Royal Cake, 13 F.3d 818, 821-22 (4th Cir. 1994). Citing the Code's broad definition of "claim", the Court held that the defendant-buyer had a "claim" against the seller when the seller received the payment and deposited it into its own account. At that point, a duty arose on the part of the seller to fulfil the contract. If the seller refused, the buyer could demand either performance or a refund, i.e., the buyer had rights against the seller which met the Code's definition of "claim". Further, the Court held that the "debt" was realized at the same time that the

"claim" arose. Any transfer of funds after that date was on account of an antecedent debt.

22. The court has concluded that the case at bar is controlled by the Royal Cake case and is easily distinguishable from the Boyles fact situation. In Royal Cake there was a completed agreement. The agreement to purchase had been assented to by both parties and any return of funds after the contract was formed would be a refund of payment made on the contract. In contrast, under Boyles, the parties did not have a completed agreement. The seller store agreed to return the payment "if [the buyer] decided to not make the purchase". Thus, the return of funds in Boyles was not a refund of a payment made on the contract, but the return of a deposit.

23. In the present case, there was a completed contract. The defendant made an offer to purchase and contract and tendered money on March 18. The Lambdin Company formally accepted that offer on March 30. Therefore, as of March 30, 1992, a contract for the construction and purchase of the residence had been formed between the parties. Both parties performed under the contract as specified in the contract.

Since the contract did not call for escrow of the amount deposited, the money was not held in trust, but became the property of the debtor, leaving the defendant with only a claim on the contract for performance. There was no breach of the contract. Although the contract stated that the earnest money deposit was to be returned if the financing obligation were not

met, this was not a precondition to the formation of a completed contract. The parties had already fully agreed and contracted with each other upon the signing of the Offer to Purchase and Contract. Therefore, any return of the earnest money at this point was a refund of a payment made, not a return of a deposit where the Lambdin Company was awaiting the defendant to decide whether or not to purchase.

The return of the "earnest money" was a transfer to a creditor on account of an antecedent debt. The defendant became a creditor upon the payment of the original deposit, that money evidenced by an executed contract, and deposit of the money into the Lambdin Company's account. Since the return of the payment was made some 5 months later, it was on account of an antecedent debt.

24. This legal analysis is confirmed by the practicalities of the fact pattern present in this case. If there were other people who had acted out the same pattern as the defendant, the Lambdin Company's funds would have been insufficient to pay them all. Thus, the first claimants would be preferred over others who made claims after the funds ran out. That is the essence of a preferential transfer and what §547 is designed to rectify. (It was merely fortuitous that that did not happen here.) That would not have been the case if the "earnest money deposit" was truly a deposit where each person's money was held for them in escrow as their separate property. The absence of such a deposit escrow further demonstrates that the defendant is a claimant for

the pool of the debtor's funds rather than a claimant for his own property.

25. The court finds that the return of the earnest money deposit was a transfer of an interest of the debtor in property to a creditor on the account of an antecedent debt. Since the parties have stipulated to the other necessary elements of a preferential transfer under §547, the court holds that the transfer was a preference.

NOW, THEREFORE, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that:

1. The transfer at issue was a preferential transfer under §547; and
2. The Trustee should recover Judgment on his Complaint.

This the 22nd day of May, 1996.



George R. Hodges
United States Bankruptcy Court