UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

IN RE:	:	CASE NO. 04-92733-JEM
	:	
Tracy Joseph Hedrick and Theresa Ann Hedrick,	:	CHAPTER 7
	:	JUDGE MASSEY
Debtors.	:	
Neil C. Gordon as Chapter 7 Trustee,	:	
Plaintiff,	:	ADVERSARY NO. 04-6420
v.	:	
NovaStar Mortgage, Inc.,	:	
Defendant.	:	

ORDER GRANTING DEFENDANT'S MOTION FOR SUMMARY JUDGMENT AND DENYING PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

In early December 2003, Tracy Joseph Hedrick and Theresa Ann Hedrick obtained a loan from NovaStar Mortgage, Inc. to refinance debt secured by two security deeds on their residence in Cobb County, Georgia. At the closing, they executed a new security deed on the residence in favor of NovaStar. A few days after the closing, the closing attorney sent checks to the holders of the prior security deeds, which they promptly cashed. NovaStar's security deed was not recorded until January 7, 2004. The security deeds of the prior lenders were marked cancelled on January 22, 2004. On April 5, 2004, eighty-nine days after NovaStar's security deed was recorded, the Hedricks filed a petition initiating this case under Chapter 7 of the Bankruptcy Code.

Neil Gordon, the Chapter 7 Trustee, contends that the recording of NovaStar's security deed constituted a transfer of an interest in Debtors' property within the 90-day period preceding the bankruptcy, while Debtors were insolvent, that enabled NovaStar to receive more than it would receive in the Chapter 7 case. He brings this adversary proceeding against NovaStar to avoid the transfer as a preference pursuant to section 547 of the Bankruptcy Code, 11 U.S.C. § 547.

NovaStar raises three defenses to Mr. Gordon's claim. First, it contends that under the doctrine of equitable subrogation, it held a perfected lien against Debtors' residence as of the time it paid the prior lenders. Second, NovaStar argues that the making of the loan and recording of NovaStar's security deed were substantially contemporaneous and therefore that it has a defense under section 547(c)(1). Finally, it contends that the loan proceeds were "earmarked" to pay the prior lenders and never became property of the Hedricks and that because a preference by definition involves a transfer of a debtor's property, there was no preference.

Both parties move for summary judgment. Pursuant to Fed. R. Civ. P. 56(c), made applicable by Fed. R. Bankr. P. 7056, a party moving for summary judgment is entitled to prevail if "the 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 judgment as a matter of law." *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). The Court held a hearing on the motions on April 11, 2005, at which the parties agreed that there is no dispute on any material fact needed to decide this dispute.

In the latter part of 2003, Tracy Joseph Hedrick and Theresa Ann Hedrick determined that they could no longer afford to make monthly mortgage payments to Astoria Federal Savings and Countrywide Home Loans, Inc., the lenders secured by first and second priority liens on their residence. To remedy this problem, they applied for a new loan from NovaStar Mortgage, Inc., which agreed to make them a loan of $148,000 on terms that would substantially lower their monthly payments.

The closing of the loan by NovaStar to Debtors took place on December 4, 2003 in the offices of McClain & Merritt, P.C. Scott Mills, an attorney with that firm, closed the loan. At the closing, the Hedricks executed a document showing their receipt of closing documents (Document 19 - Exhibits filed by NovaStar, Exhibit 8, page 32) in which they acknowledged that McClain & Merritt, P.C. represented only NovaStar.

At the closing, Debtors executed and delivered to Mr. Mills, as NovaStar's agent, a security deed in favor of NovaStar conveying legal title to Debtors' residence located in Cobb County, Georgia in exchange for a loan in the amount of $148,000. They executed a closing statement (Document 19 - Exhibits filed by NovaStar, Exhibit 8, page 30) and a document informing them of their right to rescind the transaction, each of which stated in part: "If you cancel the transaction, the mortgage/lien/security interest is also cancelled." (Document 19 - Exhibits filed by NovaStar, Exhibit 9, page 34.)

The closing statement, executed by the Hedricks, shows that the proceeds of the loan were to be used to pay off two prior loans to Astoria and Countrywide. (Document 19, Exhibit 8, p. 30.) The security deeds held by Astoria and Countrywide were the only liens against the residence. NovaStar agreed to make the loan only on condition that it would be secured by a first priority lien on the residence. By delivering the security agreement to Mr. Mills and executing the closing statement, the Hedricks acknowledged their agreement with NovaStar that it was to have a first priority lien on their residence.

The proceeds of NovaStar's loan were sufficient to pay off the two prior loans and to pay most of the closing costs. Debtors received none of the loan proceeds and had no control over the loan proceeds. Debtors had three days under federal law within which to cancel the transaction. They did not do so.

Defendant filed an affidavit of Mr. Mills (document no. 21) in which he stated that it was the practice of his firm to deliver payoff checks by overnight delivery on the "Disbursement Date," which in this case was December 10, 2003. His firm sent by Federal Express on December 10, 2003, a check payable to Astoria in the amount of $112,808.75 and a check to Countrywide in the amount of $31,944.38. The balance of the loan proceeds in the amount of $3,246.87 was used to pay closing costs. Defendant filed a second affidavit of Mr. Mills (document no. 36) showing that the checks payable to Astoria and Countrywide cleared his firm's escrow account on December 12, 2003.

In his first affidavit, Mr. Mills further averred that on December 10, 2003, a "check was written to the Clerk of the Superior Court in the amount of $444.00 for the intangibles tax" and "in the amount of $38.00 for recording fees." He further stated that "in accordance with the common practice for his office, the Security Deed was sent to the Cobb County Superior Court Clerk via regular mail together with the intangibles tax check and the recording check issued on the Disbursement Date." These statements, made in the passive voice, do not resolve the issue of precisely when Mr. Mills mailed the deed and the checks to the Superior Court Clerk.

The Superior Court Clerk marked the security deed in favor of NovaStar as "filed and recorded" on January 7, 2004. The security deeds in favor of Astoria and Countrywide were cancelled of record on January 22, 2004. Debtors filed this Chapter 7 case on April 5, 2004, eighty-nine days after the recording of NovaStar's security deed.

Section 547(b) of the Bankruptcy Code, dealing with preferences, 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;

> (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[.]

Section 547(c) establishes defenses to a claim that a transfer is avoidable as a preference. In its answer, Defendant raised defenses under subsection (c)(1) and (c)(2) but has apparently abandoned the (c)(2) defense, which, in the context of this case, is without merit anyway. Section 547(c)(1) provides:

> (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[.]

Under section 547(g), Plaintiff has the burden of proving facts to satisfy the elements of his claim under subsection (b), and Defendant has the burden of proving facts to establish its affirmative defense under subsection (c)(1). The subrogation and earmarking defenses raised by Defendant are not affirmative defenses but instead attack Plaintiff's contention that he has proved all of the elements of a voidable preference required by section 547(b).

A claim under section 547(b) that a defendant has received a voidable preference has a total of seven elements that a trustee must prove. NovaStar does not contest the first three elements, which require the trustee to show (1) a transfer (2) of property in which the debtor had an interest (3) for the benefit of the transferee. The word "transfer" is defined very broadly in section 101(54) of the Bankruptcy Code:

> "transfer" means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption[.]

The fourth element is that the transfer must have been for or on account of an antecedent debt owed by the debtor. In other words, the debtor must have been liable on the debt prior to the transfer. On December 4, 2003, the Hedricks signed the note and security deed in favor of NovaStar and delivered those documents to Mr. Mills, NovaStar's attorney. Plaintiff argues that the recording of the NovaStar security deed on January 7, 2004 constituted a preferential transfer with respect to the antecedent debt incurred on December 4.

The fifth element requires a showing that the debtor was insolvent when the transfer. If the transfer took place within the 90-day period preceding the petition date, Debtors are presumed to have been insolvent, 11 U.S.C. § 547(f), and Defendant does not dispute that Debtors were insolvent during the 90-day period preceding the filing of the Chapter 7 petition. Insolvency is irrelevant if the transfer took place prior to January 6, 2004, which was the ninetieth day before the petition date.

The sixth element, that transfer must have occurred no more than 90 days prior to the petition date, is likewise a function of the date of the transfer. (There is no contention that NovaStar was an insider of Debtors, which would have extended the preference period to one year.)

The seventh and last element of a voidable preference requires Plaintiff to show that the transfer enabled Defendant to receive more than it would receive in a Chapter 7 case. In the typical case, this element is not contested because a defendant in a preference action almost always received more from the transfer than it would receive in a Chapter 7 case had the transfer not been made and the creditor had received payment of the debt in accordance with the Bankruptcy Code.

In his brief, Plaintiff argues that the residence is the only asset of this estate that could be liquidated to pay creditors' claims and that Debtors scheduled the value of their assets at about $122,000 less than the aggregate amount of scheduled liabilities. These arguments are not a substitute for proof. In his statement of facts not in dispute, Plaintiff made no mention of values of assets available to pay creditors or the amounts of allowed claims of creditors or of projected allowed claims. Plaintiff failed to produce any evidence showing the absence of a dispute about the facts necessary to establish this element. Although Defendant may have given Plaintiff a helping hand by introducing a copy of the schedules, there is no evidence to show that Defendant would agree with the value of the residence assigned by Debtors, what other assets of the estate the Trustee may have uncovered or what claims have been filed in the case. (If no other creditor held an allowed claim, the amount Defendant would receive in a Chapter 7 case would arguably equal what it received as a result of the transfer, even if there were no assets other than the residence.)

To prove the fourth, fifth, and sixth elements of a voidable preference, Plaintiff must prove that the transfer of an interest in Debtors' residence occurred on or after January 6, 2004. Section 547(e) is the touchstone for determining when a potentially avoidable transfer is deemed to have been made for purposes of section 547. It provides in relevant part:

> (e)(1) For the purposes of this section—
>
> > (A) a transfer of real property other than fixtures, but including the interest of a seller or purchaser under a contract for the sale of real property, is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee;

. . .

(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, . . . ;
> (B) at the time such transfer is perfected, if such transfer is perfected after such 10 days; or
> (C) immediately before the date of the filing of the petition, if such transfer is not perfected at the later of—
>> (I) the commencement of the case; or
>> (ii) 10 days after such transfer takes effect between the transferor and the transferee.

. . .

Thus, for purposes of section 547, a transfer of an interest in the property to NovaStar is deemed to have been made on the date that the transfer was effective between the Hedricks and NovaStar provided that within ten days after the effective date, the transfer was perfected as set forth in subsection 547(e)(1). Otherwise, the transfer is deemed to have been made on the perfection date. Subsection (e)(1)'s definition of perfection does not involve the same elements of perfection of a lien against real estate under state law, and the two concepts should not be confused. Nonetheless, state law governs the resolution of the two issues presented here by section 547(e) – first, when the transfer of an interest in the property was first effective between the parties and, second, when a bona fide purchaser of the property could not have obtained an interest in the property equal to or superior to that possessed by NovaStar.

By delivering the security deed in favor of NovaStar to Mr. Mills as NovaStar's agent at the closing of the loan on December 4, 2003, the Hedricks conveyed to Defendant an interest in the residence, subject to their right to cancel the transaction. As between the parties themselves, delivery of a deed transferring an interest in real property is valid and binding, "absent evidence of fraud, or duress, or some other coercive action." *Lionheart Legend, Inc. v. Norwest Bank Minnesota Nat. Ass'n*, 253 Ga. App. 663, 667, 560 S.E.2d 120, 124 (Ga. App. 2002); Ga Code

Ann. § 44-14-63 and §44-2-2(c). Hence, the transfer was effective between the parties on December 4, 2003.

Plaintiff contends that the recording of the security deed on January 7, 2004 perfected a transfer of Debtors' residence to NovaStar. But the date on which a security deed becomes effective against a bona fide purchaser is the date on which it is filed, not the date on which it is recorded. Ga. Code Ann. § 44-2-2(b); 2 Pindar's Georgia Real Estate Law and Procedure, § 21-18, pp. 601-02 (6th ed. 2004). The parties agree on the recording date, and the Clerk's stamp applied to the security deed says "filed and recorded" on January 7, 2004. Nonetheless, it is possible to read Mr. Mills' affidavit as asserting that he mailed the deed to the Clerk on or shortly after the Disbursement Date, from which it might be presumed that the Clerk received the deed in December. In any event, the parties did not address this issue, and neither side has demonstrated an absence of an issue of fact as to when the security deed was actually received by the Cobb County Superior Court Clerk.

The filing date issue can be ignored, however, because there is a bigger fly in Plaintiff's preference ointment – the doctrine of equitable subrogation. The doctrine of equitable subrogation has been a part of the fabric of Georgia law for more than a century. The Georgia Supreme Court first used the term "equitable subrogation" in *Merchants & Mechanics Bank v. Tillman*, 106 Ga. 55, 31 S.E. 794 (Ga. 1898). After reviewing the general law of subrogation, the Supreme Court continued as follows:

> This rule, it will be observed, distinctly recognizes the right of one parting with his money to expressly stipulate that he shall be substituted for and occupy the position of another, whose rights in the premises he seeks to acquire; and all the authorities above cited agree that a special contract of this nature, whenever it contemplates what is commonly known as "conventional subrogation," is perfectly legitimate and enforceable. . . . Thus, "*one who advances money to pay off an incumbrance, upon an agreement with the debtor that the security shall be assigned to him, or a new one given to him, will be subrogated to the rights of the incumbrancer; and, if the new security turns out to be defective, he will be substituted to the benefit of the prior incumbrance, unless the superior or equal equities*

> *of others would be prejudiced thereby."* 24 Am. & Eng. Enc. Law, 292-294. The theory upon which a court of equity proceeds, in an instance such as that just cited, would seem to be that, where one expressly contracts with a debtor for security which will secure, the fact that he does not actually get it is immaterial, unless equal or superior rights of third persons have intervened; for, as against the debtor himself and all parties whose rights will not be injuriously affected, the contract between him and the person in good faith advancing his money should be given effect, and consequently that will be considered done which ought to have been done. In other words, such person will be deemed to occupy the situation in which he would have been placed had the contract been executed in strict conformity to the express agreement between the parties, and his rights will be measured accordingly, whenever protection of him does not also involve a disregard of the rights, legal or equitable, of others concerned.

Id. at 55-56.

In *Tillman,* Jefferson had purchased real property from Larned and had given Larned a security deed to secure a purchase money loan, which was recorded. Later, Jefferson secured a debt to Merchants and Mechanics Bank with a second security deed on the property. Jefferson then borrowed from Tillman to pay off his debt to Larned with the understanding that Tillman was to obtain a first priority security deed on the property. The transaction closed, and the security deed in favor of Larned was marked satisfied in the public records with Tillman's approval and a security deed in favor of Tillman was recorded. Tillman had not searched the public records before making the loan to Jefferson. Had he done so, he would have found the second priority security deed in favor of the bank. Further, Tillman could have obtained an assignment of Larned's deed instead of consenting to its cancellation but did not do so. Based on constructive notice of its deed and Tillman's failure to take an assignment of the prior deed, the bank contended that it held the first priority security deed on the property.

The Supreme Court rejected the bank's arguments, holding that only "culpable negligence" of a party in Tillman's position would bar equitable relief and that any doubt on the point should be decided in favor of the party claiming equitable relief. *Id.* at 60-61. Failing to check the public record and failing to obtain an assignment of Larned's position, the Court held, did not constitute negligence, let alone acts of culpable negligence.

In *Flournoy Plumbing Co. v. Home Owners Loan Corp.*, 181 Ga. 459, 182 S.E. 507 (1935), the Supreme Court upheld application of the doctrine of equitable subrogation against a judgment creditor whose lien was recorded after the filings of a purchase money security deed and tax liens but before the filing of a deed to secure a loan, the proceeds of which were used to pay off the first security deed and tax liens. The Supreme Court's most recent reaffirmation of equitable subrogation was in *Davis v. Johnson*, 241 Ga. 436, 246 S.E.2d 297 (1978). In that case, a bank held a security deed from Johnson to secure a loan. Johnson sold the property to Davis, and Davis obtained a new loan from the same bank to pay the purchase price. Unbeknownst to Davis and the bank, a judgment creditor of Johnson filed a judgment lien after the sale contract was executed but prior to the closing of the sale. The bank subsequently cancelled its security deed and thereafter discovered the judgment lien. The Supreme Court held that the cancellation of a security deed could be set aside so that in effect the bank became subrogated to its own revived security deed so as to have priority over the judgment lien.

NovaStar paid the debts to Astoria and Countrywide in full as of December 12, 2003 with the understanding and agreement of Debtors that in doing so, it was to have the first priority security interest on the residence. Under the doctrine of equitable subrogation, NovaStar became subrogated to the lien positions of Astoria and Countrywide the instant that the checks drawn on its attorney's trust account and payable to the prior lenders cleared. Thus, NovaStar held the first priority lien against the property as of the time of the payoffs.

The issue presented under section 547(e) is whether under Georgia law, a bona fide purchaser could have obtained title to the residence superior to the interest held by NovaStar subsequent to the time that the payoff checks cleared on December 12, 2003 and prior to the recording of NovaStar's own security deed on January 7, 2004.

The words "bona fide" mean "the absence of all knowledge of fraud, deceit or coercion--in short of everything which would show bad faith." *Brown v. Driggers,* 62 Ga. 354 (1879). To be a bona fide purchaser, one must pay a fair value for the property purchased. A bona fide purchaser, like any purchaser, takes subject to liens of record and liens of which the purchaser has actual knowledge.

> The general rule in Georgia is "that when property is transferred to one for value, the transferee not having actual notice of any lien against the property, and no lien being recorded, he takes the property free of the lien. But under our recording statutes, if the lien is properly recorded so as to give constructive notice of its existence to all would-be transferees, then the transferee has notice of the lien, and the transferred property in his possession is subject to the lien." *Kilgore v. Buice,* 229 Ga. 445, 448, 192 S.E.2d 256 (1972).

Matter of Fulton Air Service, 254 Ga. 649, 650, 333 S.E.2d 581, 582-83 (1985).

A hypothetical bona fide purchaser of the Debtor's residence on and after December 12, 2003 and on or before January 7, 2004 would have had constructive notice of the security deeds in the name of Astoria and Countrywide. As the Georgia Supreme Court pointed out in *Fulton Air Service*, the test is an objective one: a properly recorded lien constitutes constructive notice. The fact that a purchaser could not have known by examining the public record that NovaStar, and not Astoria and Countrywide, held the liens is irrelevant. Under the doctrine of equitable subrogation, NovaStar was subrogated to the lien rights of the prior lenders because it paid the debts owed to those lenders with the understanding with the Hedricks that it would have the first priority lien on the residence. Hence, a bona fide purchaser could not have obtained an equal or superior interest to that held by NovaStar after the checks to Astoria and Countrywide cleared on December 12, 2003, any more than he could have obtained an interest superior to the liens of Astoria and Countrywide prior to December 12, 2003. Consequently, the transfer of an interest in the residence to NovaStar was perfected, within the meaning of section 547(e)(1)(A), on December 12, 2003. Because only eight days passed from the closing to the date of perfection, the transfer of an interest by the Hedricks to NovaStar is deemed to have been made on December 4, 2003. 11 U.S.C. § 547(e).

Because NovaStar is deemed to have had a perfected security interest in the residence beginning on December 4, 2003, the recording of its security deed on January 7, 2004 was not a "transfer" for bankruptcy purposes. Recall that a "transfer" is a "mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property . . . ." The Hedricks had already parted with the interest they transferred to NovaStar in December, many days before NovaStar's security deed was recorded (and perhaps filed) on January 7, 2004. Upon the filing and recording of its security deed, NovaStar obtained no greater interest in the property than it already had, and the Hedricks did not dispose of or part with an interest in their residence that they had not already transferred by operation of the law of equitable subrogation. In the absence of a parting of an interest in property by the Hedricks, there was no "transfer" within the meaning of section 101(54) of the Bankruptcy Code. For purposes of perfection under section 547(e)(1), the filing and recording of NovaStar's security deed merely substituted that security deed for Astoria's and Countrywide's security deeds without changing the respective interests of NovaStar and the Hedricks in their residence.

Because the transfer of an interest in Debtors' property to NovaStar is deemed to have occurred on December 4, 2003, Plaintiff cannot prove three elements of a voidable preference. The fourth element (payment of an antecedent debt) and the sixth element (a transfer within 90 days of the petition date) never existed because the transfer is deemed to have been contemporaneous with the creation of the debt on December 4, 2003. Even if another transfer to NovaStar were deemed to have taken place on January 7, 2004, Plaintiff cannot prove the seventh element that NovaStar received more from that transfer than it would in the Chapter 7 case. NovaStar's security interest in the property was perfected under Georgia's law of equitable subrogation as well as under section 547(e) from December 12, 2003 forward, and consequently it holds a secured claim in the bankruptcy case that the Trustee cannot successfully challenge. The fifth element (insolvency) fails because Plaintiff relied on the presumption of insolvency.

Plaintiff advances several arguments in an unsuccessful effort to show that a bona fide purchaser would have been able to obtain an interest in the property equal or superior to the interest that NovaStar had between December 12, 2003 and January 7, 2004.

Plaintiff's primary argument is that a bona fide purchaser takes free of an unrecorded interest of which it had no notice, that NovaStar's security deed was unrecorded and, therefore, that a bona fide purchaser would have acquired Debtors' residence free of any interest that NovaStar had. To reach this conclusion, Plaintiff posits that in examining the chain of title, a bona fide purchaser would have discovered the unsatisfied security deeds, would have made an inquiry of Astoria and Countrywide and would have learned that the loans were paid in full, thereby "proving that the Prior Lienholders' security deeds were unenforceable." Plaintiff's Supplemental Brief (Document No. 41). He does not assume that the purchaser would have made an inquiry of the owners. At that point, Plaintiff asserts, a bona fide purchaser would take the property with an expectation that no enforceable encumbrance of record would exist.

Implicit in Plaintiff's argument is a contention that the Court is authorized to assume facts that Plaintiff selects and that are not in evidence in order to decide the dispute. Plaintiff has not shown and could not show that a purchaser of real estate in the factual setting presented would invariably find out that the prior loans had been paid in full but would never discover in the process the existence of NovaStar's security deed. The outcome of any case can be altered by assuming "facts" that, considered alone, create a claim or undermine a defense. Section

547(e)(1)(A) tests perfection by reference to a hypothetical bona fide purchaser of the property. But that is as far as the hypothetical goes. The only knowledge chargeable or attributable to a hypothetical bona fide purchaser is what the public record shows. In a case with a real bona fide purchaser, that purchaser's personal knowledge and actions might be relevant, but a hypothetical purchaser knows only what is on the public record and does not make limited inquiries of real persons having other information. If such assumptions by a plaintiff were permitted, the defendant could advance his own set of "facts" about the hypothetical bona fide purchaser's inquiries. Plaintiff's methodology would result in endlessly stacking of the evidentiary deck as each side assumes a factual circumstance to counter one assumed by the other.

A bona fide purchaser, real or hypothetical, would be presumed to know the law and therefore to know that the mere fact that loans secured by the prior deeds had been paid in full would not eliminate the possible existence of a new lender subrogated to the rights and priorities of the prior lenders. Consequently, even if the bona fide purchaser made Plaintiff's limited inquiry and learned that the prior loans had been paid, he could not use the fact of payoff as a proxy for the absence of a lien. The simple solution to the problem every purchaser faces when a title examination reveals an unsatisfied security deed is to insist on the recording of satisfaction of the prior security deed before paying any new value to the sellers. Plaintiff did not assume such a prudent course of action for the obvious reason that it would defeat his claim, just as he did not assume that a purchaser would have inquired of the Hedricks whether there was any unrecorded lien against the property and that the Hedricks would have answered honestly.

Plaintiff's legal conclusion is also in error. He posits that once a loan secured by real property is paid in full, the security deed, though still of record, is completely unenforceable for all purposes. This conclusion collides head-on with the doctrine of equitable subrogation. Even if Astoria and Countrywide, having been paid in full, could not themselves have enforced covenants in their respective security deeds, an entity entitled to rely on the doctrine of equitable subrogation would have enjoyed the same lien position that Astoria and Countrywide enjoyed. To adopt Plaintiff's legal conclusion would be to ignore Georgia law as laid down by its Supreme Court in cases applying the doctrine of equitable subrogation.

Plaintiff has pointed out that all of the equitable subrogation cases involved intervening or existing liens against the properties at issue. None involved a bona fide purchaser. This is a meaningless distinction, however. The doctrine is based on equity. It strives to reach a result that does not disappoint expectations. In the case of an intervening judgment lien creditor, for example, that creditor has constructive notice of the security deed securing the loan that is later paid off; he knows he is in second place. The subrogation of a new lender to the lien of prior lender paid off with the new loan does not upset the judgment creditor's expectation of his place in the priority scheme. Similarly, a hypothetical bona fide purchaser of property on which there is an outstanding security deed has no legally cognizable expectation that he will acquire the property free and clear of the lien of that deed.

Citing *Wilkins v. Gibson*, 113 Ga. 31, 30 S.E. 374 (1901), Plaintiff points out that equitable subrogation protects a party with a defective security instrument only "if not chargeable with culpable and inexcusable neglect" and if the holder of a superior or equal lien would not be thereby prejudiced. *Id*. at 382. Based on this holding, Plaintiff makes his next argument that NovaStar was guilty of culpable and inexcusable neglect in failing to record its security deed promptly after it was executed.

This argument is also without merit. Nothing in the record shows any neglect by NovaStar, much less "culpable and inexcusable" neglect. Plaintiff contends that the act constituting culpable negligence was NovaStar's failure to file its security deed within the ten-day period imposed by section 547(e). This argument loses sight of the fact that NovaStar would have had to have been clairvoyant in late 2003 and early 2004 to know that section 547(e) would be implicated. Indeed, section 547(e) imposes no duty on a lender to record a security deed within ten days of the date on which the transaction is effective between the parties. Therefore, a delay in recording a security deed cannot be negligence because negligence is the tort of unreasonably failing to perform a legal duty. Nor was it culpable negligence to fail to take an assignment of the positions of the former lenders, as the Georgia Supreme Court in *Tillman* expressly stated. Retroactively superimposing the ten-day period set forth in section 547(e) on state law to support a tort of culpable negligence would offend federalism by disregarding Georgia law concerning the priority of liens and interest in property.

Waiting too long to file a security deed may have adverse consequences for the party holding the unfiled security instrument, but its dilatory conduct would have an adverse effect only as to its own rights. Thus, the Georgia Supreme Court in holding in *Wilkins* that culpable and inexcusable negligence would alter the equitable valence must have been referring to conduct that harmed another entity. Plaintiff cannot show harm to anyone.

A hypothetical bona fide purchaser could not be said to be prejudiced by the delay in the recording of a security deed because being charged with the knowledge of the law of equitable subrogation and of the outstanding security deeds, he could not presume that the debt had not been refinanced. Hence, a hypothetical bona fide purchaser could no suffer damage by the subrogation of NovaStar to the former lenders' lien positions. In short, Plaintiff has not shown a duty owed by NovaStar to a hypothetical bona fide purchaser, an unreasonable breach of that duty by NovaStar or damages suffered by the hypothetical purchaser.

Finally, Plaintiff attacks the doctrine of equitable subrogation as a nefarious method of defeating a preference. For example, he asserts that Defendant "may not rely on the doctrine of equitable subrogation to mediate its tardy and preferential recordation of the Security Deed."

Plaintiff's Supplemental Brief, p. 4 (Doc. No. 41). Similarly, he asserts that "to allow a party to disregard the well known time limits for the relation-back recording as set forth in 11 U.S.C. § 547 . . . would prejudice the 'superior or equal equities' of the bona fide purchaser . . . ." Plaintiff's Supplement Brief, p. 5 (Doc. No. 41). These arguments are incoherent. In the first argument quoted above, Plaintiff commits the logical error of begging the question of when the transfer was made. Because the transfer is deemed to have been made on December 4, 2003, more than 90 days prior to the petition date, it was not preferential. As to the second argument, this Court is not disregarding, or permitting NovaStar to disregard, the time limits imposed by section 547 on equitable or any other grounds. Plaintiff loses, not because anyone is disregarding section 547 to "mediate" a preferential recording of a deed, but rather because the transfer was not a voidable preference in the first place.

Neither party has remarked on the effect, if any, under the doctrine of equitable subrogation, of the difference between the aggregate amount of debt owed to Astoria and Countrywide and the slightly larger amount of NovaStar's loan. Consequently, any contention that the difference in loan amounts would make a difference in the analysis under the doctrine of equitable subrogation is waived It is difficult to construct an argument that the differential in the loan amounts is material. A holder of a second priority security deed is always at risk to a larger loan secured by the first position if the first priority security deed has a dragnet clause or a future advances clause. Likewise, a bona fide purchaser would have nothing to complain about because he can protect himself by obtaining a satisfaction of the prior security deed before he closes the purchase.

It is not necessary to comment on NovaStar's other two defenses, except to say that standing alone, they would be suspect.

For these reasons, it is

ORDERED that Plaintiff's motion for summary judgment is DENIED, and Defendant's motion for summary judgment is GRANTED.

This 31st day of August 2005.

JAMES E. MASSEY
U.S. BANKRUPTCY JUDGE