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U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

NOT FOR PUBLICATION

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UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

In re:)	BAP No.	NC-13-1365-KiDJu
)		
ERNEST LINCOLN BONNER, JR.,)	Bk. No.	11-72110-WJL
)		
Debtor.)	Adv. No.	12-4177
)		
_____)		
ELAINE W. WALLACE,)		
)		
Appellant,)		
)		
v.)	MEMORANDUM¹	
)		
ERNEST LINCOLN BONNER, JR.,)		
)		
Appellee.)		
_____)		

Argued and Submitted on February 20, 2014,
at San Francisco, California

Filed - March 6, 2014

Appeal from the United States Bankruptcy Court
for the Northern District of California

Honorable William J. Lafferty, III, Bankruptcy Judge, Presiding

Appearances: Appellant, Elaine W. Wallace, Esq., argued pro se;
Craig K. Welch, Esq. of the Law Office of Craig K.
Welch argued for appellee, Ernest Lincoln Bonner,
Jr.

Before: KIRSCHER, DUNN and JURY, Bankruptcy Judges.

¹ This disposition is not appropriate for publication.
Although it may be cited for whatever persuasive value it may have
(see Fed. R. App. P. 32.1), it has no precedential value. See 9th
Cir. BAP Rule 8013-1.

1 Appellant Elaine W. Wallace ("Wallace") appeals a summary
2 judgment order avoiding her unperfected security interest under
3 11 U.S.C. § 544(a)(1)² and preserving it for the benefit of the
4 estate. Because Wallace did not raise a genuine issue of material
5 fact in opposition to the debtor's motion for summary judgment, we
6 AFFIRM.

7 I. FACTUAL BACKGROUND AND PROCEDURAL HISTORY

8 A. Wallace's loans to debtor

9 Wallace, an attorney, met debtor Ernest Lincoln Bonner, Jr.
10 ("Bonner") in approximately 1993 through her law firm employee.
11 Bonner is a physician and also attended law school. Wallace's
12 employee was Bonner's law school classmate. During their
13 friendship, Bonner provided medical services to Wallace and her
14 family, and he would occasionally stop by Wallace's law office and
15 come to her home for dinner.

16 In October 1997, Bonner approached Wallace for a loan.
17 According to Wallace, Bonner informed her that for the past few
18 months he had been attempting to collect on previously
19 uncollectible medical liens worth "hundreds of thousands of
20 dollars." Bonner was confident he could collect on these debts,
21 but told Wallace that he needed some money to tide him over during
22 the process. Wallace, who represents federal employees in
23 administrative proceedings, was reluctant at first, but after
24 Bonner's repeated assurances that she would be protected from any
25 loss, even if Bonner filed bankruptcy, Wallace agreed to make the

26
27 ² Unless specified otherwise, all chapter, code and rule
28 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and
the Federal Rules of Bankruptcy Procedure, Rules 1001-9037. The
Federal Rules of Civil Procedure are referred to as "Civil Rules."

1 loan.

2 In exchange for the funds, on October 27, 1997, Bonner
3 executed a promissory note payable to Wallace for \$45,350.00 with
4 10% simple interest. The due date for the note was July 27, 1999.
5 The note also purported to give Wallace a security interest in
6 various medical and office equipment belonging to Bonner Medical
7 Corporation – a one-time entity of Bonner's. Bonner allegedly
8 told Wallace that she did not need to do anything further to
9 protect herself; the note created an enforceable security
10 interest, and all she had to do was put it away for safekeeping.
11 Wallace claimed that she relied on Bonner's statements.

12 In January 1998, Bonner approached Wallace for a second loan.
13 Bonner allegedly told Wallace that he was unable to collect on the
14 medical liens, but that he was soon expecting money for services
15 he had provided to Medi-Cal/Medicare patients, which was more than
16 enough to pay back everything he owed her. After Bonner provided
17 Wallace with the same assurances that she would be protected,
18 Wallace agreed to make the second loan. In exchange for the
19 second loan, on January 2, 1998, Bonner executed a similar
20 promissory note payable to Wallace for \$16,000.00 with 10% simple
21 interest. The note purported to give Wallace a security interest
22 in the same medical and office equipment, as well as Bonner's
23 accounts receivable. As with the first note, Bonner allegedly
24 told Wallace that she did not need to do anything further to
25 protect herself from any loss.

26 Wallace never filed a UCC-1 Financing Statement ("UCC-1")
27 with the California Secretary of State to perfect her security
28 interest in the named collateral. According to Wallace's records,

1 over the course of thirteen years (1997-2010) Bonner paid Wallace
2 a total of \$53,400.00.

3 **B. Bonner's instant bankruptcy case and adversary proceeding**
4 **against Wallace**

5 Bonner filed an individual chapter 11 bankruptcy case on
6 November 16, 2011. No trustee has been appointed, and Bonner
7 remains the debtor in possession.

8 Wallace filed an amended proof of claim asserting a secured
9 claim for \$127,094.94 and an unsecured claim for \$70,183.74.
10 Bonner did not object. After Bonner filed the instant bankruptcy
11 case, Wallace discovered through PACER that he had filed four
12 previous chapter 13 cases, two in 1998 and two in 2008. Wallace
13 never received notice of any of Bonner's prior bankruptcies,
14 either formally or otherwise, even though she was a creditor
15 during these time periods.

16 **1. Bonner's adversary complaint**

17 Bonner filed an adversary complaint against Wallace seeking
18 to avoid her unperfected security interest in the accounts
19 receivable and equipment under § 544(a)(1) and to preserve the
20 avoided interest for the benefit of the bankruptcy estate under
21 § 551. In her answer, Wallace asserted several affirmative
22 defenses, including that the debt was excepted from discharge
23 under § 523(a)(2) based on Bonner's fraud.

24 In an attempt to settle the matter, on November 19, 2012,
25 Wallace and Bonner filed a stipulation allowing Wallace a secured
26 claim for \$45,000.00 and allowing the remainder of her claim as an
27 unsecured claim for \$152,378.68. No order was ever entered. The
28 bankruptcy court later stated at the hearing on Bonner's motion

1 for summary judgment that it denied the stipulation because
2 Wallace had not provided anything to support an enforceable
3 security interest in property of Bonner's estate.³

4 **2. Bonner's motion for summary judgment**

5 Bonner moved for summary judgment on his complaint ("MSJ"),
6 arguing that no material facts were in dispute. Because Wallace
7 had failed to perfect her security interest in the accounts
8 receivable and equipment by filing a UCC-1, Bonner argued that he
9 could assert his right as a hypothetical judicial lien creditor
10 and avoid Wallace's unperfected security interest using the
11 strong-arm provision of § 544(a)(1) and preserve that interest for
12 the estate under § 551. A hearing was set for June 19, 2013.

13 In her amended opposition to the MSJ, Wallace contended that
14 her affirmative defense no. 4 – that the loan debt was excepted
15 from discharge under § 523(a)(2)(A) and (B) based on Bonner's
16 fraud – precluded summary judgment. In her attached declaration,
17 Wallace set forth facts to support a nondischargeability claim
18 under § 523(a)(2)(A) and (B). Wallace asserted that she did not
19 file a UCC-1 because of Bonner's assurances that she was protected
20 from any loss, even if he filed bankruptcy, and that she did not
21 need to do anything further to protect herself other than put the
22 notes in a safe place. Wallace also argued that distributions in
23 Bonner's bankruptcy case should follow California law.

24 Specifically, because California law gives creditors with an
25 unperfected security interest priority over an unsecured
26 creditor's claim, Wallace argued that her claim should be given

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28 ³ See Hr'g Tr. (June 19, 2013) 3:24-4:4.

1 priority over other general unsecured claims. Finally, Wallace
2 contended that an equitable lien should be imposed because she had
3 relied on Bonner's false representations that perfection was not
4 required to protect her security interest, citing Funk v. G.W.
5 Custom Homes, LLC (In re Funk), 2011 WL 3300350 (9th Cir. BAP
6 May 11, 2011)(unpublished).

7 In his reply, Bonner argued that even if Wallace's debt was
8 excepted from discharge, the lien securing her claim would still
9 be avoidable under § 544(a). Nonetheless, argued Bonner, the debt
10 was dischargeable because the time to file a nondischargeability
11 action had expired. In sum, Bonner argued that his conduct and
12 liability were not at issue here. This was not an objection to
13 Wallace's claim; this was an action to avoid her lien.

14 **3. The bankruptcy court's ruling on the MSJ**

15 The hearing on the MSJ lasted approximately four minutes,
16 with neither party offering oral argument. The bankruptcy court
17 announced its ruling in favor of Bonner, finding that Wallace had
18 not taken the proper steps to perfect her security interest, and
19 the fact that Bonner "may or may not have made some statements
20 that may or may not have been correct, that may or may not have
21 supported a § 523(a)(2) complaint [was] neither here nor there."
22 Hr'g Tr. (June 19, 2013) 4:7-12. Bonner's misstatements, which
23 might have supported a § 523(a)(2) claim, did not create an
24 affirmative defense to an avoidance action under § 544(a)(1), even
25 though it might have supported a lawsuit against him, which
26 Wallace never brought.

27 In the MSJ order entered on July 24, 2013, the bankruptcy
28 court determined that a claim under § 523(a)(2)(A) was not a

1 cognizable affirmative defense to an avoidance action; the purpose
2 of that statute had no relationship to the avoidance of an
3 unperfected security interest. Therefore, because Wallace had not
4 filed a UCC-1 with the California Secretary of State to perfect
5 her security interest as against the rights of third parties, her
6 interest was unsecured.

7 Alternatively, the bankruptcy court determined that even if a
8 claim under § 523(a)(2)(A) were cognizable under the
9 circumstances, Wallace's reliance was not justifiable. Bonner
10 never represented that he would file the UCC-1 to perfect her
11 security interest, and Wallace was a sophisticated party who had
12 previous experience with bankruptcy cases and, prior to finalizing
13 their agreement, vocalized her wish that Bonner protect her
14 interests. As such, Wallace's professional and practical
15 knowledge belied any reliance on Bonner to take the simple step of
16 filing the UCC-1.

17 The bankruptcy court also determined that no grounds existed
18 to impose an equitable lien on the estate's assets because Wallace
19 had made no attempt to perfect her own interests. The court found
20 Wallace's reading of In re Funk as "overly narrow" and that she
21 had misstated the case's actual holding. In the court's opinion,
22 In re Funk held that an equitable lien may not be imposed when the
23 lienholder possessed other remedies at law to protect its
24 interests.

25 The bankruptcy court entered a separate judgment on July 29,
26 2013, avoiding Wallace's security interest under § 544 and
27 ordering that it be preserved for the benefit of the bankruptcy
28 estate under § 551. Wallace's timely appeal followed.

1 Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986).

2 Wallace raises several arguments for why Bonner was not
3 entitled to summary judgment. We address each argument in turn.

4 **1. Section 544(a) and the California Commercial Code**

5 Section 544(a), the "strong-arm clause," gives a bankruptcy
6 trustee special powers to set aside transfers or liens against
7 property of the bankruptcy estate. Specifically, § 544(a)(1)
8 "grants a trustee in bankruptcy 'the rights and powers of a
9 hypothetical creditor who obtained a judicial lien on all of the
10 property in the estate at the date the petition in bankruptcy was
11 filed.'" Neilson v. Chang (In re First T.D. & Inv., Inc.),
12 253 F.3d 520, 526 (9th Cir. 2001)(quoting Brady v. Andrew
13 (In re Commercial W. Fin. Corp.), 761 F.2d 1329, 1331 n.2 (9th
14 Cir. 1985) (citing § 544(a)(1)).⁴ "'One of these powers is the
15 ability to take priority over or "avoid" security interests that
16 are unperfected under applicable state law" Id. (quoting
17 In re Commercial W. Fin. Corp., 761 F.2d at 1331 n.2). "Avoiding
18 such interests relegates them to the status of a general unsecured
19 claim."⁵ Id. (citing 5 COLLIER ON BANKRUPTCY ¶¶ 544.02, 544.05
20 (Lawrence P. King ed., 15th ed. rev. 2000)).

21 The applicable state law in this case, the California
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25 ⁴ Although § 544 specifically gives avoidance powers only to
26 a "trustee," § 1107(a) gives a chapter 11 debtor in possession all
27 of the rights, powers and duties of a trustee, with certain
28 exceptions not relevant to this case.

⁵ A general unsecured claim is the same as an unsecured
nonpriority claim.

1 Commercial Code⁶ ("CAL. COM. CODE"), provides that an unperfected
2 security interest is subordinate to the rights of a "lien
3 creditor." CAL. COM. CODE § 9317, subd. (a)(2).⁷ A security
4 interest in accounts receivable and business equipment - i.e.,
5 personal property - is perfected by filing a UCC-1 with the
6 California Secretary of State. CAL. COM. CODE § 9310, subd. (a).⁸

7 Wallace concedes that she did not perfect her security
8 interest in accordance with California law by filing a UCC-1. As
9 a result, Bonner, as a hypothetical lien creditor, could avoid
10 Wallace's unperfected security interest pursuant to § 544(a)(1).

11 **2. The bankruptcy court did not err in determining that a**
12 **claim under § 523(a)(2) could not be an affirmative**
13 **defense to an avoidance action under § 544(a).**

14 Wallace contends that summary judgment was improper because
15 she raised the affirmative defense of fraud under § 523(a)(2)(A)
16 and (B), and the bankruptcy court erred in holding that such
17 claims were not a cognizable defense to an avoidance action under
18 § 544(a).

19 ⁶ Unless otherwise noted, all references to Division 9 of
20 the California Commercial Code are to such Division as it was
21 revised and effective on Jan. 1, 2007.

22 ⁷ CAL. COM. CODE § 9317, subd. (a)(2) provides, in relevant
23 part: "A security interest . . . is subordinate to the rights of
24 . . . a person that becomes a lien creditor before the earlier of
25 the time the security interest . . . is perfected, or one of the
26 conditions specified in paragraph (3) of subdivision (b) of
27 Section 9203 is met and a financing statement covering the
28 collateral is filed."

29 ⁸ CAL. COM. CODE § 9310, subd. (a) provides: "Except as
30 otherwise provided in subdivision (b) and in subdivision (b) of
31 Section 9312, a financing statement must be filed to perfect all
32 security interests and agricultural liens." Wallace has not
33 contended or shown that any exceptions noted above apply in this
34 case.

1 Wallace has not cited, and we could not locate, any authority
2 to support her contention that a nondischargeability claim under
3 § 523(a)(2) can be raised as an affirmative defense to a trustee's
4 avoidance action under § 544(a). The two statutes have no
5 relationship with one another and serve entirely different
6 purposes: nondischargeability of a debt versus avoiding a
7 creditor's unperfected lien. Further, even if the debt to Wallace
8 were deemed nondischargeable, Bonner as trustee could still have
9 avoided her unperfected security interest. While an unfortunate
10 situation, we are unable to apply § 523(a)(2) as an affirmative
11 defense to the trustee's strong-arm powers under § 544(a). In the
12 context of lien avoidance, either Wallace perfected her lien or
13 she did not. Accordingly, we discern no error by the bankruptcy
14 court.

15 Wallace takes issue with the bankruptcy court's silence as to
16 her argument under § 523(a)(2)(B). Because a nondischargeability
17 claim under any paragraph of § 523(a) could not support a defense
18 to an action under § 544(a), the bankruptcy court did not need to
19 address Wallace's argument and therefore did not err by not
20 addressing it.

21 **3. Once her unperfected security interest was avoided,**
22 **Wallace's claim became an unsecured nonpriority claim by**
23 **operation of bankruptcy law and is not entitled to**
24 **priority.**

25 Wallace contends that the bankruptcy court erroneously
26 "converted" her claim into an unsecured nonpriority claim, even
27 though California law gives priority to creditors holding
28 unperfected security interests over creditors with unsecured
claims. In other words, Wallace contends she has priority over

1 all other unsecured nonpriority creditors in Bonner's bankruptcy
2 case.

3 We agree with Wallace that under California law, a creditor
4 with an attached but unperfected security interest has priority
5 over an unsecured creditor's claim. People v. Green,
6 125 Cal.App.4th 360, 377 (2004)(citing CAL. COM. CODE § 9201,
7 subd. (a) and Bank of Stockton v. Diamond Walnut Growers, Inc.,
8 199 Cal.App.3d 144, 155 (1988)). However, California priority law
9 does not apply when it comes to distributions in bankruptcy.

10 Priority of distribution in bankruptcy is a question of
11 federal, not state law. See Am. Sur. Co. of N.Y. v. Sampsell,
12 327 U.S. 269, 272 (1946)("[F]ederal bankruptcy law, not state law,
13 governs the distribution of a bankrupt's assets to his
14 creditors."); Matter of Quanta Res. Corp., 739 F.2d 912, 920
15 (3d Cir. 1984)(state law regulating distribution of assets among
16 creditors must give way to the "all-encompassing federal law of
17 creditors' rights"); Sticka v. Applebaum (In re Applebaum),
18 422 B.R. 684, 694 (9th Cir. BAP 2009)(Markell, J., dissenting)
19 ("[I]t is well-settled that federal law has primacy over contrary
20 state law, especially in the area of bankruptcy distribution.")
21 (citing Sampsell and Elliott v. Bumb, 356 F.2d 749, 755 (9th Cir.
22 1966)("state creation of priorities in various classes of
23 creditors . . . would tend to thwart or obstruct the scheme of
24 federal bankruptcy")); In re Macomb Occupational Health Care, LLC,
25 300 B.R. 270, 292 (Bankr. E.D. Mich. 2003).

26 Under federal bankruptcy law, Wallace has not shown that she
27 is entitled to priority over other unsecured nonpriority
28 creditors. She has made no argument that her claim fits under any

1 paragraph of § 507(a), and we see none under which it could apply.
2 Accordingly, the bankruptcy court did not err in determining that
3 Wallace's claim is an unsecured nonpriority claim.

4 **4. The bankruptcy court did not err in determining that**
5 **Wallace had not shown any grounds to impose an equitable**
6 **lien on the estate's assets.**

7 Lastly, Wallace argues that a material issue of disputed fact
8 existed as to whether she set forth any grounds to support an
9 equitable lien on the estate's assets. Namely, Wallace contends
10 that she justifiably relied on Bonner's misrepresentations, which
11 is why she did not perfect her security interest. In addition,
12 she argues that the bankruptcy court erroneously interpreted
13 In re Funk as holding that an equitable lien may not be imposed
14 when the lienholder possessed other remedies at law to protect its
15 interest, and, based on that erroneous interpretation, erred in
16 concluding she was not entitled to an equitable lien because she
17 could have filed a UCC-1, but failed to file one.

18 We do not disagree with the bankruptcy court's interpretation
19 of In re Funk. Presumably, the only reason the court even
20 discussed the case, which is unpublished and not even binding on
21 this Panel, is because it was the only authority Wallace raised in
22 her five-sentence argument as to why an equitable lien should be
23 imposed. However, the bankruptcy court's interpretation of
24 In re Funk is of no moment, since we are able to affirm its ruling
25 on other grounds supported by the record. Balint, 180 F.3d at
26 1054.

27 Even if Wallace was entitled to an equitable lien and was
28 granted one by the bankruptcy court, it would still be subordinate
to Bonner's interest as a hypothetical judgment lien creditor and

1 avoidable. Palmer v. Wash. Mut. Bank (In re Ritchie), 416 B.R.
2 638, 646 (6th Cir. BAP 2009); In re Hendleman, 91 B.R. 475, 476
3 (Bankr. N.D. Ill. 1988)(equitable lien in debtor's property is by
4 definition unperfected and can never survive attack by trustee);
5 Hunter v. Ohio Citizens Bank (In re Henzler Mfg. Corp.), 36 B.R.
6 303, 306 (Bankr. N.D. Ohio 1984)("[E]ven if MFG could claim an
7 equitable lien it would nevertheless be subordinate, under the
8 relevant provisions of UCC, to a subsequent legal lien of a
9 judgment creditor and is invalid against the Trustee in this case
10 who has asserted his hypothetical lien creditor status under
11 § 544(a)(1)."); Hassett v. Revlon, Inc. (In re O.P.M. Leasing
12 Servs., Inc.), 23 B.R. 104, 120 (Bankr. S.D.N.Y. 1982)("The
13 legislative history of the Bankruptcy Code makes clear that
14 Article 9 of the U.C.C. treats equitable liens as 'unperfected
15 security interests which the trustee can in any case set
16 aside.'). Therefore, a trial on this issue would serve no
17 purpose.

18 VI. CONCLUSION

19 Because the bankruptcy court did not err when it determined
20 that no genuine issue of material fact existed, and that Bonner
21 was entitled to summary judgment as a matter of law, we AFFIRM.
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