

**"Not For Publication in West's Bankruptcy
Reporter."**

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF COLUMBIA

In re)
)
MILLENNIUM PRODUCTIONS,) Case No. 00-01410
INC.,) (Chapter 7)
)
Debtor.)
_____)
)
WENDELL WEBSTER, Trustee of)
the Chapter 7 Estate of)
Millennium Productions,)
) Adversary Proceeding
Plaintiff,) No. 01-10177
)
v.)
)
MALCOM LAZIN,)
)
Defendant.)

DECISION SUPPLEMENTING ORAL
DECISION RE MOTION FOR SUMMARY JUDGMENT

In this preference action under 11 U.S.C. § 547, Wendell Webster, trustee under chapter 7 of the Bankruptcy Code of the estate of the debtor, Millennium Productions, LLC, seeks to recover a \$500,000 transfer from the debtor, to the defendant, Malcolm L. Lazin. This decision supplements the court's oral decision with respect to Lazin's principal defense that a constructive trust had arisen in his favor on the \$500,000, because of the debtor's alleged fraud with respect to recording a security interest in Lazin's favor, so that the transfer was not a transfer of property of the debtor.

Lazin's constructive trust defense is an attempt to

invoke equity to perfect his alleged security interest in the subject fund after he failed to insist, as a condition to making his loan to the debtor, that the debtor furnish him a signed security agreement and a signed financing statement so that he could take the simple steps required by article 9 of the District of Columbia's Uniform Commercial Code ("UCC")¹ to perfect his alleged security interest. The debtor's subsequent failure to record a financing statement and the debtor's false statements to Lazin that a financing statement had been filed do not suffice to create a constructive trust under the law of the District of Columbia.

I

The defendant Malcolm L. Lazin lent \$400,000 to the debtor on April 20, 2000, for the debtor's required operational expenses. In exchange, the debtor gave Lazin a promissory note requiring the debtor to pay Lazin \$500,000 on May 1, 2000. The loan was to be repaid from the proceeds generated by the debtor at its Millennium Festival held on April 29 and 30, 2000. The debtor paid Lazin \$500,000 on May 3, 2000. The debtor's bankruptcy case commenced on May 5,

¹ The version of article 9 applicable here is D.C. Code Ann. §§ 28:9-101 et seq (1981), and the court will use the shortened citation to its provisions as UCC § 9-101 and so forth. The transactions here occurred prior to the amendments to article 9 that were effective July 1, 2001.

2000.

Lazin's affidavit states that on April 18, 2000, he and representatives of the debtor (including Jose Ucles) had a lunch meeting "whereby the various loan documents were signed." The affidavit further states:

9. It was always understood by me and the others at the lunch meeting that my loan would be secured by the total proceeds (including gate and vendor fees and sale proceeds) of the Millennium Festival to be held shortly thereafter and that Mr. Ucles would file the necessary documents to perfect my security interest.

10. At that time, Mr. Ucles stated that he would file the appropriate loan documents to perfect my security interest in the proceeds from the Millennium Festival held on April 29 and 30, 2000.

11. A few days after the loan documents were signed, I spoke with Mr. Ucles who stated to me that he had filed the appropriate loan documents to perfect my security interest in the proceeds from the Millennium March on Washington.

Although Lazin has produced the promissory note executed with respect to the loan, he has produced no document constituting a security agreement or a financing statement. These facts do not suffice to establish a constructive trust, nor do they suffice to establish the existence of an equitable lien on the \$500,000 of funds paid to Lazin on May 3, 2000.

II

The trustee has adduced evidence establishing all of the elements of an avoidable preference under 11 U.S.C. § 547(b).

The proof that \$500,000 was transferred from the debtor's bank account to Lazin suffices to carry the trustee's burden of proving the element that there was a transfer of an interest of the debtor in property. Because the debtor owned the bank account and presumably had both the legal and equitable interest in the bank account, the trustee's papers also establish that the transfer enabled Lazin to receive more than he would had the transfer not been made and Lazin received payment of such debt to the extent provided by the provisions of the Bankruptcy Code governing this chapter 7 liquidation case, there being insufficient estate assets to pay all unsecured claims in full. That shifts to Lazin the burden of adducing evidence to establish that although the debtor had legal title to the funds transferred to Lazin, he held equitable title to those funds.

III

In addressing what would have transpired had the transfer not been made, property of the estate would include that which the trustee could recover under 11 U.S.C. §§ 544(a)(1), 550, and 551. 11 U.S.C. § 541(a)(3) and (4). Although 11 U.S.C. § 541(d) refers to property of the estate under subsections (a)(1) and (2) as not including property to the extent of any equitable interest in such property that the debtor does not

hold, subsections (a)(3) and (4) of § 541 operate independently of § 541(d). See Lewis v. Hare (In re Richards), 275 B.R. 586, 589 (Bankr. D. Colo. 2002) (rejecting minority position of In re Quality Holstein Leasing, 752 F.2d 1009 (5th Cir. 1985) (interpreting earlier version of § 541(d)); and In re Haber Oil Co., Inc., 12 F.3d 426 (5th Cir. 1994), and agreeing with the majority view of In re Seaway Express Corp., 912 F.2d 1125 (9th Cir. 1990)). Here the trustee asserts that any constructive trust or equitable lien would itself be subject to defeat by the trustee as a hypothetical judgment lien creditor under 11 U.S.C. § 544(a)(1). Accordingly, if the outcome would differ depending upon whether the court followed Seaway Express instead of Haber Oil, the court would follow Seaway Express. As will be seen, however, the outcome does not differ: Lazin was not entitled to a constructive trust or an equitable lien under District of Columbia law.

IV

The trustee urges that a constructive trust and an equitable lien, as equitable remedies, cannot arise until a court decrees the existence of the trust or lien. See XL/Datacomp, Inc. v. Wilson (In re Omegas Group, Inc.), 16 F.3d 1443, 1451 (6th Cir. 1994). However, the Sixth Circuit

has made clear that Omegas Group does not apply when a constructive trust or equitable lien arises **by operation of law** prepetition, even if its existence is declared postpetition. In re Morris, 260 F.3d 654, 668 (6th Cir. 2001). I will assume, without deciding, that under District of Columbia law a constructive trust or equitable lien arises as of the date of the wrongful conduct giving rise to the trust or lien.

V

A constructive trust is a restitutionary device effectuating the proposition that "[w]hen property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee." Beatty v. Guggenheim Exploration Co., 122 N.E. 378, 380 (N.Y. 1919) (Cardozo, J.), quoted in Harrington v. Emmerman, 186 F.2d 757, 761 n.9 (D.C. Cir. 1950). See also Hertz v. Klavan, 374 A.2d 871, 873 (D.C. 1977) ("[a] constructive trust is a flexible remedial device used to force restitution in order to prevent unjust enrichment."). Lazin has not shown that a constructive trust is appropriate here. The debtor borrowed from Lazin, a former Assistant United States Trustee, in a commercial transaction in which there is no question that Lazin intended

to part with title to the funds lent because he intended the debtor to have the use of such funds to operate its festival, and he intended to look for repayment as a creditor. There was no fraud upon Lazin or any mistake in his losing title to the lent funds.²

At most, Lazin's complaint is that there was fraud in his not being made the holder of a perfected security interest. However, that fraud would go not to a question of restitution, of restoring title, but to securing Lazin as against other creditors. The equitable remedy Lazin really seeks is not restoration of title but the fixing of a lien on the \$500,000 of funds that were used to pay him.

VI

Although not specifically identifying the equitable remedy by its correct name, what Lazin really seeks is the imposition of an equitable lien.

A.

"Broadly speaking, equity may impose a lien to effectuate

² Lazin suggests that he was misled by the debtor's representations of what the debtor would do with the proceeds of its operations, and that some of the debtor's funds were siphoned off illegally. That is irrelevant because the moneys transferred to Lazin and at issue here obviously were not siphoned off: they remained property of the debtor and ought to be available to pay all of the debtor's creditors, not just Lazin.

some underlying agreement between debtor and creditor or in other circumstances where justice requires. See, e.g., M.M. & G., Inc. v. Jackson, 612 A.2d 186, 191 (D.C. 1992) (equitable lien for value of improvements made by bona fide purchaser to property conveyed by forged deed).” Wolf v. Sherman, 682 A.2d 194, 197 (D.C. 1996). However, Wolf implicitly recognized that the authority to impose equitable liens may not extend to a creditor who has failed to take steps available to it under statutory law to perfect a consensual security interest. Wolf, in upholding an attorney’s lien, pointedly observed that “[t]he District of Columbia has no statute governing liens by an attorney against a client for attorney’s fees.” Id. at n.5. It further emphasized that “[s]tatutes may regulate the formalities for creation and perfection of valid consensual liens and the circumstances in which they can be created and enforced,” and mentioned Article 9 security interests with respect to personalty in making this statement. As discussed next, justice does not warrant the imposition of an equitable lien in Lazin’s favor.

B.

Although no District of Columbia decision explicitly has ruled against a secured creditor who fails to take the necessary steps readily available to it under the UCC to

perfect its lien, there is no reason to believe that the District of Columbia would fail to follow decisions so holding. Justice does not warrant granting such a creditor an equitable lien when it could have insisted on the receipt of a signed financing statement as a condition to advancing the debtor funds. As observed in Small v. Beverly Bank, 936 F.2d 945, 950 (7th Cir. 1991), quoting In re Einoder, 55 B.R. 319, 328 (Bankr. N.D. Ill. 1985), "[a] creditor who [fails] to take all the steps required to perfect a lien should not be allowed to fall back on an assertion of an equitable lien to frustrate the Bankruptcy Code policy of recognizing only perfected interests in property." Cf. Marshall v. District of Columbia, 458 A.2d 28, 29 (D.C. 1982) (equity jurisdiction is lacking when the absence of a remedy at law is due to the plaintiff's failure to pursue that remedy; equitable relief is only appropriate when it has been impossible despite the plaintiff's best efforts to obtain a decision at law).

As observed in a similar contest in First Nat'l Bank of Boston v. United States, 1990 WL 235671, *2 (D. Mass. 1990):

Yellow Maize's alleged malfeasance had absolutely no effect on the Bank's ability to perfect its interest when it should have, namely at the time that it advanced the money. Instead of following this financially prudent course, the Bank chose instead simply to trust Yellow Maize. Now that this trust has proven ill-placed, the Bank seeks the protection of a security procedure that it failed to follow. The Bank is entitled to the protection

of the federal/state statutory scheme and no more. To grant the Bank the equitable protection it now seeks would be to ignore the salutary statutory purpose of allowing individuals to protect security interests in property only if they give notice to the world that they indeed have such an interest. See M.G.L. ch. 106, § 9-301(1)(d) (unperfected security interest is subordinate to a lien arising before the security interest is protected). See In re Gringeri Bros., 14 B.R. 396 (Bankr. D. Mass. 1981) (failure to comply with statutory scheme for perfection not excused by reliance on debtor when creditor could have insisted on compliance as a precondition to sale).

See also Mottaz v. Keidel (In re Keidel), 613 F.3d 172, 174 (7th Cir. 1980) (bank could have enforced debtor's duty to provide bank with documents required for perfection "by making its performance a condition of advancing the funds" [citation omitted]). As the court in Keidel, 613 F.2d at 175, further observed:

The Bank contends that the result here produces a windfall for the bankrupt's estate at the expense of the secured creditor, which furnished the purchase price of the mobile home. This may indeed be the result in this case, but the Bank has only itself to blame for failure to perform its statutory duty prescribing application for a new title. The Illinois law applicable to secured transactions in personal property, including motor vehicles, places strong emphasis on the need for diligence in perfection of the security interest in accordance with the statutory method. [Statutory citation omitted.] The strong policy favoring diligence in perfection (and the consequent gain in certainty and regularity) outweighs the possibility here of "unjust enrichment" or a "windfall."

Lazin did not use maximum effort to protect himself, and thus is not entitled to an equitable lien. As this court observed

in McCoy's Waste Indus. & Mfg., Inc. v. Adams Nat'l Bank (In re McCoy's Waste Indus. & Mfg., Inc.), 1995 WL 908054, *25-26 (Bankr. D.D.C. 1995) (bold emphasis added):

The UCC incorporates principles of equity to supplement its provisions. UCC § 1-103. In re Bridge, 18 F.3d 195, 204 (3d Cir. 1994); see Rinn v. First Union Nat. Bank of Maryland, 176 B.R. 401, 410, 413 (D. Md. 1995). The equitable lien doctrine is applied when the creditor is prevented by the debtor's lack of cooperation from perfecting the security interest. In re Trim-Lean Meat Products, 10 B.R. 333 (D. Del. 1981); In re Einoder, 55 B.R. 319, 327 (Bankr. N.D. Ill. 1985); In re O.P.M. Leasing Services, Inc., 23 B.R. 104, 119 (Bankr. S.D.N.Y. 1982). But the corollary of this rule is that the creditor must have taken all reasonable steps to assure that it obtained a perfected lien. Trim-Lean, 10 B.R. at 335; O.P.M. Leasing, 23 B.R. at 119; In re Rettig, 32 B.R. 523, 524-25 (Bankr. D. Del. 1983) (equitable lien "only if the creditor has done everything within its power to perfect its lien"). In In re Solar Energy Sales & Serv., Inc., 4 B.R. 364 (Bankr. Utah 1980), a lender was granted a security interest in a car sold to the debtor. Utah law provided for perfection by the lien being recorded on the certificate of title. The creditor gave the debtor the necessary documents and money for the personal property tax to file with the state motor vehicle division and the debtor failed to submit them. Utah law did not require that the debtor submit the application for a certificate of title upon which the seller's lien would be noted. Accordingly, the creditor could have submitted the application and thereby assured that a certificate of title was issued reflecting its lien, thereby perfecting its lien. In the circumstances, the court declined to find an equitable lien, reasoning:

... Maximum effort on the part of the creditor is a necessary element to the finding of an equitable exception. The exception is available only to those who were unfairly denied statutory perfection through no fault or lack of effort on their own. [Citation omitted.] ...

The equitable exception ... is a narrow

exception to the statutory rule. By necessity, such relief must be limited to the creditors who do all that they reasonably can do under the circumstances, but who are unfairly deprived of perfection by an uncooperative debtor.

Solar Energy, 4 B.R. at 371-73. Applying the logic of Solar Energy here, the court concludes that Lundell [the creditor who held a security interest] has not shown appropriate grounds for invocation of the equitable lien doctrine. Lundell could have insisted upon receiving a financing statement as a condition to its turning over the machine to the debtor. **That Lundell may have been reasonably diligent in pursuing MWI for the financing statement after the machine was delivered does not excuse Lundell's failure to use its leverage to insist that a financing statement be issued to it prior to or at the time of delivery of the machine.** Lundell's failure to exercise that leverage is its own fault. To allow it an equitable lien would unreasonably defeat the policy behind the UCC financing statement of assuring that there is public notice of security interests before rights of judgment lien creditors will be defeated. See In re Washington Communications Group, Inc., 10 B.R. 676, 679 (Bankr. D.D.C. 1981).

After he had already lent the funds to the debtor, Lazin may have been lied to regarding the filing of a financing statement; however, he does not say that he insisted on immediate transmission to himself of a file-stamped copy. More importantly, he could have avoided relying on the debtor to file the financing statement and relying on the debtor's statements regarding whether a financing statement was filed by insisting on receipt of the signed statement as a condition to lending the funds. As between the debtor and himself, Lazin might have been entitled to sue to require the debtor to

furnish the necessary financing statement to perfect his security interest, but that equitable right does not give him the right to an equitable lien that is prior to the trustee as an ideal judgment creditor.³

VII

In any event, Lazin has not adduced evidence to show that he had a valid security interest to begin with. He says that various loan documents were signed, but never says that a security agreement was signed. That would be fatal to an enforceable security interest. UCC § 9-203(1)(a).

The same lack of evidence exists with respect to a signed financing statement. The court is left to speculate whether

³ See Cherno v. Dutch American Mercantile Corp., (In re Itemlab, Inc.), 353 F.2d 147, 153 (2d Cir. 1965) ("Had an equitable lien been found to exist, the applicable law of New York in any event would defer the priority of such liens to subsequent legal liens of judgment creditors and, therefore, to the claim of the trustee in bankruptcy."); In re Oriental Rug Warehouse Club, Inc., 205 B.R. 407 (Bankr. D. Minn. 1997) ("application of equitable principles is inappropriate where a UCC provision is determinative." [citation omitted]); Garst Seed Co. v. Wilson, 17 Kan. App. 2d 130, 833 P.2d 138 (1992) (UCC rejects theory of equitable liens); Plains Cotton Coop. Assoc'n of Lubbock, Texas v. Julien Co. (In re Julien Company), 141 B.R. 359 (Bankr. W.D. Tenn. 1992) ("in light of the UCC provisions discussed above which set forth the requirements for liens enforceable against third parties, it may not be concluded that PCCA possesses an equitable lien, that has priority over the institutional lenders' security interest even though it may in fact have had an agreement, equitably and legally enforceable against the prepetition debtor. See, e.g., UCC §§ 9-203; 9-113.").

there was ever a signed financing statement, and, if so, whether it identified the debtor by the correct name and whether it correctly identified collateral in a manner that would have extended the perfection of the security interest to the bank funds that were used to make the payment being avoided here. Lazin bore the burden of protecting himself by insuring that the financing statement listed the debtor by the correct name and that it correctly identified the collateral. If a mistake occurred in that regard, the security interest would be unperfected and subject to defeat by a judgment lien creditor. See District of Columbia v. Thomas Funding Corp., 593 A.2d 1030, 1033 (D.C. 1991). All we know is that Lazin left it to Ucles to file the "necessary papers," and Lazin does not expound upon what he and Ucles thought would suffice to perfect the security interest. Ucles sent the bank a letter directing that payment be made to Lazin from the bank account on a date certain, and perhaps Ucles thought that was all that was necessary to achieve perfection of a security interest. Lazin would not be entitled to an equitable lien based on Ucles' misunderstanding of what was required to perfect a security interest. Lazin has not stated that he insured that there was a financing statement in proper form, and that Ucles agreed that Ucles would file the financing

statement with the Recorder of Deeds.

Given the absence of proof of the existence of the documents required to create and perfect a security interest in the proceeds of the Millennium Festival, and regarding their precise contents, any misleading statements by the debtor regarding filing the documents to perfect the security interest cannot be said to have resulted in any harm to Lazin.

For all we know on this record, Ucles may have filed a financing statement that was deficient in form (by a mistake in the spelling of the debtor's name or by failure adequately to describe the collateral) or that was filed in the wrong location: we have no affirmative proof that no financing statement was filed, and Lazin elected not to pursue taking Ucles' deposition in this regard. We have only an inference that can be drawn from Lazin's affidavit that he has not found one, but we do not know where he looked.

As already noted, a mistake in the contents of a filed financing statement is not a basis for allowing the creditor priority over a subsequent judgment lien creditor. Thomas Funding Corp., 593 A.2d at 1033. Similarly, the UCC would provide Lazin limited relief in the case of a misfiled financing statement by giving him priority over a holder of a security interest with knowledge of the misfiling of the

financing statement, UCC § 9-401(2), but the trustee as an ideal lien creditor under 11 U.S.C. § 544(a)(1) would not be charged with such knowledge. Had Lazin checked with the Recorder of Deeds of the District, Lazin could have verified that a financing statement was or was not filed, and, if there was a mistake in the place of filing (or in the contents of the filing), to seek to have the debtor take steps to correct the mistake.

Ultimately, however, Lazin's plight can be traced to his own unreasonable conduct, an act of bad faith as against subsequent creditors, in failing in the beginning to insist on receipt of a signed financing statement as the condition for lending funds, and in leaving it to the debtor to file the financing statement. If "the goof is failure to file a financing statement at all[,] . . . the goofer is out of luck if another secured party enters the picture." Clark, The Law of Secured Transactions Under the Uniform Commercial Code, ¶ 3.8[1] at 3-44 (1980 ed.). The UCC, with exceptions of no relevance here, "constitute[s] a pure 'race' statute, where the order of filing or perfection is king and knowledge is irrelevant." Id. at 3-43. Even if a judgment lien creditor knew of Lazin's alleged security interest, the UCC would permit the judgment lien creditor to take priority over Lazin

by executing prior to Lazin's filing a financing statement. Resort to equity to give Lazin a secured position in the form of an equitable lien would be contrary to the UCC's implicit requirement of good faith reasonable diligence in taking steps in creating and perfecting the security interest in order to achieve priority over a judgment lien creditor. Equity can no more grant Lazin a lien on the basis that one was intended than it can based on a lie, regarding filing, in which the debtor was able to engage only because Lazin unreasonably left it wholly to the debtor to take the steps to perfect the security interest.

VIII

Moreover, with respect to both any claim of a constructive trust or an equitable lien, Lazin bears the burden of tracing. Old Republic Nat'l Title Ins. Co. v. Tyler (In re Dameron), 155 F.3d 718, 723-24 (4th Cir. 1998). His papers fail to establish tracing of the funds he lent to the specific funds at issue here, leaving it to the court to speculate that the funds lent can be traced to the funds later transferred to him. Plainly, the \$100,000 interest paid Lazin (which was in addition to the \$400,000 principal repayment) cannot be traced to the original \$400,000 lent. Nor has Lazin undertaken even the barest attempt to engage in a tracing of

the remaining \$400,000 paid him as having its source in the original \$400,000 loan. All we know is that he lent funds for operating a festival and that shortly after the festival was held, he was repaid. That does not supply the necessary proof that there were not other movements of cash out of and into the bank account that would prevent a presumption that the funds paid him could be traced to the funds he lent.

Dated: June 11, 2002.

S. Martin Teel, Jr.
United States Bankruptcy Judge

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