UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

In re: Betsy Marie Sand, Debtor.	**Bky. No. 98-35868** Chapter 7 Case
Michael S. Dietz, Trustee of the Estate of Betsy Marie Sand, Plaintiff, v. Cenex Harvest States Cooperatives, Defendant.	**Adv. No. 99-3069** **ORDER FOR SUMMARY JUDGMENT**

I. Introduction

This matter came before the Court on cross motions for summary judgement in the above captioned adversary proceeding. Michael Dietz, Trustee of the Bankruptcy Estate of Betsy Marie Sand, appeared as Plaintiff. Lisa Ann Zell appeared for the Defendant, Cenex Harvest States Cooperative (Cenex). The Trustee seeks to void the Debtor's pre-petition unrecorded transfer of property to Cenex, using the "strong arm" provisions of either 11 U.S.C. § 544(a) (1) or (3). The Defendant argues that state law protects Cenex's ownership interest, notwithstanding its failure to record a deed, because of the actual or constructive notice created by Defendant's use of the property. The Court has jurisdiction over this adversary proceeding under 28 U.S.C. 1334, this case is a core proceeding under 28 U.S.C. 157(b)(2)(k).

The Debtor, Betsy Marie Sand, filed a petition under Chapter 7 of the Bankruptcy Code on October 6, 1998. This adversary proceeding was commenced on March 1, 1999. The facts in this matter are not in dispute. Prior to the bankruptcy filing, on July 22, 1998, Cenex Harvest State

Cooperative purchased the property[1] at issue from the Debtor and her husband. The deed of sale was never recorded by the Defendant. The Defendant did take possession, using the property to park company owned vehicles. According to the undisputed facts[2], there were at least eight to ten vehicles, each displaying the Defendant's CENEX logo, parked on the property at any time. After taking possession of the property the Defendant also cleared the lot of two junk vehicles, a wood pile, and two utility buildings.

II. Summary Judgment

Summary judgment is required under Bankruptcy Rule 7056 "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 a judgment as a matter of law." Fed. R. Bankr. P. 7056(c). The Plaintiff Trustee conceded during arguments that there were no disputed facts in this proceeding. Considering the undisputed facts as related in the affidavits on file, "the [c]ourt views the fact[s] in a light most favorable to the nonmoving party and allows that party the benefit of all reasonable inferences to be drawn from the evidence." *Prudential Ins. V. Hinkel*, 121 F.3d 364 at 366 (8th Cir. 1997). Summary judgment is appropriate because legal determinations under 11 U.S.C. § 544a(1) and (3) resolve all issues in this adversary proceeding.

III. The Trustee's Avoidance Powers under 11 U.S. C. § 544(a) (1) and (3)

The Trustee relies on the statutory language in 11 U.S.C. § 544(a) to argue that he is entitled to

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[1]Legally described as : Section 11, Township 101, Range 007, PT NW 1/4, SE 1/4 Being 198 FT N & 89 FT E & W.

[2]Affidavit of Gary Solie, Defendant's Motion for Summary Judgment.

avoid the unrecorded sale and subsequent transfer of property to Cenex. The statute allows that:

> (a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and the powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by –
> (1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained a judicial lien, whether or not such a creditor exists;
> . . .
> (3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists. 11 U.S.C. 544(a).

Both (1) and (3) create hypothetical tests to determine the Trustee's ability to avoid the transaction in this case. The Trustee's status as either a lien creditor (under 523(a)(1)), or as a bona fide purchaser (under 523(a)(3)) "is conferred upon the Trustee . . . regardless of his own personal knowledge of any relevant facts." *Joanis v. Wayzata Bank & Trust Company (In re Investment Sales Diversified, Inc.)*, 49 B.R. 837 at 843 (Bankr. D. Minn. 1985). While this provision protects the rights of a trustee who might have personal knowledge of the particulars of a property transfer before being appointed as trustee, it does not relieve a trustee of notice requirements otherwise binding on a lien creditor or bona fide purchaser.

The Trustee' authority is derived under Federal law, but his rights vis a vis the property are determined under the substantive law of the state in which the property resides. "The Code vests him with the rights of a bona fide purchaser of real property from the debtor or a creditor having a judicial lien or an unsatisfied execution. The trustee's rights under section 544 are derivative. They are those of

a creditor under state law." *Norwest Bank St. Paul v. Berquist (In re Rolain)*, 823 F.2d 198, 199 (8th Cir. 1987).

Trustee's Rights as a Hypothetical Lien Creditor

Under 11 U.S.C. §544(a)(1) the Trustee has "the status of a hypothetical lien creditor without knowledge, giving it rights paramount to the holder of an unperfected security interest." *Armstrong v. Dakota Western Bank of Bowman (In re Arithson)*, 175 B.R. 313 at 318 (Bankr. D. N. N.D. 1994). The Trustee's Complaint alleges that the unrecorded "[d]eed and transfer represented thereby is void to the trustee by virtue of the provisions of 11 U.S.C. §544(a)(1) . . ." Compl., No. 5. The Defendant argues that notice requirements under Minnesota law prevent the Trustee from exercising his avoiding power under §544(a)(1). The Trustee provides no case law to support his position, but relies instead upon the plain language of Minnesota Statute 507.34 which allows:

> 507.34. Unrecorded conveyances void in certain cases
> Every conveyance of real estate shall be recorded in the office of the county recorder of the county where such real estate is situated; and every such conveyance not so recorded shall be void as against any subsequent purchaser in good faith and for a valuable consideration of the same real estate, **or any part thereof, whose conveyance is first duly recorded, and as against any attachment levied thereon or any judgment lawfully obtained at the suit of any party against the person in whose name the title to such land appears of record prior to the recording of such conveyance.** The fact that such first recorded conveyance is in the form, or contains the terms of a deed of quitclaim and release shall not affect the question of good faith of such subsequent
> purchaser or be of itself notice to the subsequent purchaser of any unrecorded conveyance of the same real estate or any part thereof. Minn. Stat. §507.34, *emphasis added.*

Minnesota case law directs that "[t]he recording act serves to shield a record owner's judgment

creditors against claims to the real estate of which the creditors have no notice" *Nussbaumer v. Fetrow*, 556 N.W.2d 595 at 598 (Minn. App. 1996)[3]. Under the holding in *Nussbaumer*, "the protection of the act is lost to creditors with actual, constructive, or inquiry notice of a third party's rights in the property inconsistent with the judgment debtor's." *Id.* at 598.

> Section 507.34 in effect provides that an unrecorded conveyance of an interest in real estate is void against a judgment creditor who acts in good faith. Section 507.34 does not protect a creditor who has either actual or constructive notice of inconsistent rights of another. A judgment creditor is not entitled to the protection afforded by section 507.34 if the creditor possessed knowledge of facts sufficient to have put him on inquiry notice of the conveyance. Possession by a vendee under a contract for deed operates as full notice of his rights to creditors of the vendor. *Hentges v. P.H. Feely & Son, Inc.,* 436 N.W.2d 488 at 492 (Minn. Ct. App. 1989), *citations omitted*.

Whether the Trustee can avoid the transfer of property to the Defendant rests upon a determination of the "objective circumstances" of Cenex's possession and use of the property at the time the Debtor filed for bankruptcy. *Id.* In this case the undisputed record is that at the time of filing the Defendant held exclusive control of the property. In *Hentges* the Minnesota Court of Appeals held that possession by a contract for deed vendee put the lien creditor on constructive notice. *Id., see also Union Investment Co. v. Abell*, 181 N.W. 353 at 355 (Minn. 1921).

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[3]The holding in *Nussbaumer* rejects, without citing, the analysis in *Thomson v. United States,* 66 F.3d 160 (8th Cir. 1995), which overturned a district court determination that the Internal Revenue Service's Tax lien prevailed over a non-debtor's unrecorded ownership interest. The Court of Appeals concluded that "if the State's recording act only makes an unrecorded transfer void or voidable as against subsequent judgment creditors or bona fide purchasers, the transferor retains no post-transfer interest. *Thomson* at 163. Observing that Minnesota's statute is of precisely this type, the Eighth Circuit held that the statute's protection for judgment creditors only protects one "who buys real estate in reliance upon the record." *Id. citing Miller v. Hennen*, 438 N.W.2d 366, 369 (Minn. 1989). Under the Eighth Circuit's analysis this Court would need to first determine if the Debtor had any property right at filing against which the Trustee's hypothetical lien could attach.

Under the undisputed record in this case, Cenex's use, possession, and modification of the property would have placed any potential lien holder on notice of Cenex's rights in this property. The Trustee's attempt to avoid the unrecorded deed of the Defendant under 11 U.S.C. §544(a)(1) is denied.

Trustee's Rights as a Hypothetical Bona Fide Purchaser

The Trustee also seeks to avoid Cenex's unrecorded deed under the bona fide purchaser provision of 11 U.S.C. § 544(a)(3). Cenex argues that notwithstanding the language of Minn. Stat. 507.34, the Trustee cannot avoid the Defendant's valid property interest because any bona fide purchaser would have had constructive or actual knowledge of Cenex's open and actual possession of the property since the July 22, 1998 purchase.

> [T]he trustee is charged with constructive notice of claims contrary to his title under 544(a)(3) if an otherwise bona fide purchaser is charged with constructive notice under Minnesota real property law. Clearly such a Minnesota bona fide purchaser is bound by constructive notice. *Beutel v. Joanis (In re Investment Sales Diversified, Inc.)*, 38 B.R. 446 at 453 (Bankr. D. Minn. 1984) *Footnotes omitted.*

To determine the Trustee's rights as a hypothetical bona fide purchaser, the Court reviews the facts on October 6, 1998, the date the above captioned bankruptcy petition was filed. As reviewed above, those facts are not in dispute. Cenex had exclusive and open control of the property: "Third-party possession of property constitutes inquiry notice . . . if it is 'an actual, open, visible, and exclusive possession' inconsistent with the title of the record owner." Nussbaumer, 556 N.W.2d at 598, *quoting Farmers State Bank*, 234 N.W. at 321.

While not all possession is inconsistent with the ownership indicated by the chain of title,[4] in this

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[4]In *Nussbaumer v. Feltrow* the Minnesota court of Appeals upheld a district court's finding that "the building of a house on the lot was not, so far as the judgment lien creditors were concerned,

case the Trustee has offered no evidence to suggest a bona fide purchaser could have believed that the property was still properly titled to the Sands. Cenex's exclusive possession and use of the property at the time of the bankruptcy filing placed any potential bona fide purchaser on inquiry notice to determine Cenex's rights. The Trustee's action under 11 U.S.C. § 544(a) to avoid the sale and unrecorded deed to Cenex fails.

IV. Disposition

Based upon the proceedings, arguments of counsel, all of the files and records herein, and pursuant to the Federal and Local Rules of Bankruptcy Procedure, **IT IS HEREBY ORDERED THAT**:

1. The Defendant's motion for summary judgment in the above captioned adversary proceeding is granted in its entirety The Plaintiff Trustee has no interest in the property legally described as : Section 11, Township 101, Range 007, PT NW 1/4, SE 1/4 Being 198 FT N & 89 FT E & W.

2. The Plaintiff's cross-motion for summary judgment is denied in its entirety.

LET JUDGMENT BE ENTERED ACCORDINGLY.

Dated: April 20, 2000.

By the Court:

/e/ Dennis D. O'Brien
Dennis D. O'Brien
Chief U.S. Bankruptcy Judge

NOTICE OF ELECTRONIC ENTRY AND FILING ORDER OR JUDGMENT
Filed and Docket Entry made on 04/20/00
Patrick G. De Wane, By SKM

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hostile to the judgment debtor's recorded title, but directly in line with it." 556 N.W.2d 595 at 599. The courts noted that construction contractors often build homes on property they do not own.