UNITED STATES BANKRUPTCY COURT

DISTRICT OF MINNESOTA

THIRD DIVISION

In Re:

Gerald Butler, CHAPTER 7

Debtor.

Bky. Case No. 93-34300

Molly T. Shields, Trustee of the Bankruptcy Estate of Gerald Butler, Adv. No. 95-3221

Plaintiff,

vs. ORDER

Jero Partnership II, a Minnesota general partnership, American Inland Corporation, Gerald N. Butler, Freidson Realty Company, a Minnesota general partnership, and Perlco, a Minnesota general partnership

Defendants.

This matter is before the Court on Defendants Freidson and Perlco's motion for summary judgment and Plaintiff Trustee's cross-motion for summary judgment. The motion was heard on October 11, 1996; appearances are as noted in the record at the hearing; and, the Court now makes this ORDER pursuant to the Federal and Local Rules of Bankruptcy Procedure.

I.

FACTS

In 1989, Defendant Jero purchased real estate known as the GE property. At that time, the Jero partnership consisted of two general partners: Gerald Butler and William Barbush. In February 1991, Mr. Butler transferred his interest in the Jero partnership to Robert Holupchinski. In January 1991, William Barbush transferred his interest in Jero to AIC of Minnesota, a corporation for which Mr. Butler was the president. AIC of Minnesota transferred its interest in Jero to AIC of Colorado, a corporation for which Mr. Butler's 13 year old son was the sole shareholder, and Mr. Butler was the sole director and president. In September 1993, Mr. Butler filed for Chapter 7 bankruptcy. In March of 1994, First Trust National Banking Association started foreclosure proceedings against the GE property. Robert Holupchinski transferred his interest in the Jero partnership and the GE property back to Mr. Butler around this time.

In June 1994, Freidson and Perlco purportedly purchased the GE property from AIC of Colorado.(FN1) In June 1994, Freidson and Perlco leased the property to Mr. Butler and AIC of Colorado with an option in favor of AIC of Colorado to purchase the property.

The Plaintiff Trustee brought this action after learning of the transaction, seeking to avoid the transfer as an unauthorized post-petition transfer of estate property under 11 U.S.C. Section 549(a).(FN2) Plaintiff claims that at the bankruptcy filing, Mr. Butler owned the entire equitable interest in the property, and therefore, the bankruptcy estate held the interest purportedly transferred to Freidson and Perlco. The Defendants, Freidson and Perlco, deny that the estate ever had any interest in the property. They argue that the GE property is not property of the bankruptcy estate as it was one-half corporately owned and one-half owned by Holupchinski at filing of the bankruptcy case.

Defendants also claim that they are good faith purchasers for value under Section 549(c); and, that they are entitled to rely on the public real estate records under the Minnesota Recording Act as against any prior unrecorded claim of the Trustee. They claim that the record did not show any interest of either the Trustee or Mr. Butler in the property at the time of their transaction.

Freidson and Perlco moved for summary judgment on their claims that they are good faith purchasers under Section 549(c); and, that they are protected by the Minnesota Recording Act. The Plaintiff made a cross-motion for summary judgment, alleging that ownership of the GE property was determined previously by this Court's April 17, 1995 order in Norman Goldetsky and Percy Greenberg v. Gerald Butler, Adv. No, 3-93-286. The Trustee argues that the determination is binding in this proceeding.

II.

DISCUSSION

Federal Rules of Bankruptcy Procedure Rule 7056 provides that Rule 56 of the Federal Rules of Civil

Procedure applies to adversary proceedings. Rule 56(c) provides that summary judgment shall be entered 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.

The moving party has the burden of demonstrating that there is an absence of a genuine issue of material fact. In re Calstar, 159 B.R. 247, 251 (Bankr. D. Minn. 1993). However, the non-moving party must "do more than simply show that there is some metaphysical doubt as to the material facts." Matsushita Electric Industrial Co., Inc. v. Zenith Radio Corp., 475 U.S. 574, 586, 106 Sup. Ct. 1348, 1355, 89 L.Ed.2d 538, 552 (1986). For the reasons discussed below, partial summary judgment is appropriate in this case.

A) 11 U.S.C. Section 549(a)

The Trustee seeks to avoid a post-petition transfer of the GE property to Freidson and Perlco pursuant to Section 549. A trustee may avoid a transfer of property of the estate under Section 549(a):

(1) that occurs after the commencement of the case; and

(2)(B) that is not authorized under this title or by the court

In re Calstar, sets out 3 elements which must be established in order for the trustee to avoid a transfer under Section 549. The trustee must prove:

(1) that property of the estate was transferred;

(2) after the filing of a petition;

(3) which was not authorized by the Code or by the court

Calstar, 159 B.R. at 252.

The Trustee or Defendants must establish that there is no genuine issue of any material fact as to all three of these elements in order for summary judgement to be proper.

(1) Property of the estate

The Trustee claims that the Court determined that Mr. Butler had the equitable interest in the GE property at filing of the bankruptcy case, and that the Defendants are collaterally estopped from arguing that the GE property is not presently property of the bankruptcy estate. It is the Trustee's position that in Norman Goldetsky and Percy Greenberg v. Gerald Butler, Adv. No, 3-93-286, the Court determined that the GE property is property of the bankruptcy estate. The Trustee argues that the determination controls in this proceeding under the doctrine of collateral estoppel.

In order for collateral estoppel to be applied, the following four elements must be met:

(1) the issue sought to be precluded must be the same as that involved in the prior action;

(2) the issue must have been litigated in the prior action;

(3) the issue must have been determined by a valid and final judgment; and

(4) the determination must have been essential to the

prior judgment.
In re Miera, 926 F.2d 741, 743 (8th Cir. 1991).

Collateral estoppel serves many functions, including conserving time and resources of both the parties and the court. Oldham v. Pritchett, 599 F.2d 274, 279 (8th Cir. 1979). However, the most important function of collateral estoppel is that it is a method of avoiding conflicting rights and duties which would arise from inconsistent judgments. Oldham, 599 F.2d at 279.

The Trustee argues that the entire issue of whether the GE property is presently property of the bankruptcy estate is a proper issue for the application of collateral estoppel. However, collateral estoppel is appropriate only for consideration of the narrow issue of whether, at the time Mr. Butler filed for bankruptcy, he owned the equitable interest in the GE property.

(a) Same Issue

This Court found in Goldetsky v. Butler that Butler held the entire equitable interest in the GE property at the time he filed his bankruptcy petition.(FN3) The same issue is involved in this proceeding as was involved in the April 17, 1995 order, in that the estate's present claim is based on Butler's interest in the property at filing.

(b) Issue litigated in the prior action

The issue of Mr. Butler's interest in the GE property was at issue in the hearing generating the April 17, 1995 order. That hearing was to determine whether Mr. Butler was entitled to a discharge in bankruptcy. Mr. Butler had every incentive to fully litigate the issue of his interest in the property, as his bankruptcy discharge depended on the resolution by this Court. This Court found that one of the reasons he was not entitled to a discharge was because he did not disclose his interest in the GE property on his bankruptcy schedules.

(c) Issue essential and determined by a valid and final judgment

This Court's April 17, 1995 order is a valid and final order, as it was never appealed, and the time for appeal has long since expired. The Court's determination, that Butler owned the equitable interest in the GE property at bankruptcy filing, was essential to the decision that under 11 U.S.C. Section 727(a)(2)(A), Butler was not entitled to a discharge for failure to disclose the interest.

Therefore, all four elements are met. The question remains, however, whether collateral estoppel can be applied against Defendants Freidson and Perlco, who were not parties to the Goldetsky action.

An essential focus of the collateral estoppel analysis is whether the person against whom collateral estoppel is being applied had a "full and fair" opportunity to litigate the issue at the prior adjudication. In re Miera, 926 F.2d at 743. The focus is on whether the application of collateral estoppel will work an injustice against the party whom estoppel is to be applied. Oldham, 599 F.2d at 279. Such a determination is to be on a case by case basis. Oldham, 599 F.2d at 279.

Butler is a named defendant in this proceeding. Collateral estoppel clearly applies to him regarding ownership of the equitable interest in the GE property at

his bankruptcy filing. The question is whether application of collateral estoppel on the issue of Butler's ownership would serve as an injustice to Freidson and Perlco, who: were not parties to the first action; and, who had no opportunity to litigate the issue in the context of their own claims to the property. Application of the doctrine against the Defendants Freidson and Perlco is appropriate.

All of the events, upon which Butler's interest in the GE property was determined, occurred prepetition and before Freidson and Perlco purportedly acquired any rights in the property. Freidson and Perlco had no connection or involvement with any of the events. They had no justiciable interest in the determination of Butler's interest in the property at bankruptcy filing. They were strangers to the events and the issues. Freidson and Perlco are not entitled to relitigate those issues here.

B) 11 U.S.C. Section 549(c) And Minnesota Recording Act

Section 549(c) provides that a trustee may not avoid a transfer of real property under Section 549(a):

> to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value...

Minnesota law provides for the recording of real estate titles in the office of County Recorder for the county where the real estate is located. Minnesota Statute Section 507.34 provides:

> [E]very ... conveyance [of real property] 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....

The Defendants argue that they are good faith purchasers for value within the exception of Section 549(c); and, that they are protected under the Minnesota Recording Act, because they reasonably relied on the public record, which did not disclose any interest of Mr. Butler or the Trustee in the property. They claim that actual or implied knowledge of Mr. Butler's bankruptcy would not effect their status as bona fide purchasers, and is, irrelevant to the consideration. Accordingly, the Defendants argue, they are entitled to summary judgment.

The Defendants claim that they are entitled to rely solely on the public record for protection under the Recording Act. Apparently, the relevant county real estate records showed that title to the property was vested in Jero Partnership II at the time of the Freidson and Perlco transaction.

Minnesota case law indicates that a party cannot rest on the record alone. Claflin v. Commercial State Bank of Two Harbors, 487 N.W.2d 242, 248 (Minn.App. 1992).(FN4) A party seeking protection under the Recording Act must also be a good faith purchaser, which means that the party must have no actual, implied, or constructive notice of inconsistent outstanding rights of others. Miller v. Hennen, 438 N.W.2d 366, 369 (Minn. 1989). Courts traditionally look to the steps, besides examining the record, that those seeking

protection under the recording act took in order to determine if there were any inconsistent rights in the property. Miller, 438 N.W.2d 366; Claflin, 487 N.W.2d 242. The burden of proof in establishing good faith purchaser status is on the party claiming the protection. Miller, 369.

Good faith, for purposes of Section 549(c), also depends upon whether the transferee knew or should have known that the debtor's purpose for the transaction was to defraud creditors. In re Robbins, 91 B.R. 879, 886 (Bankr. W.D. Mo. 1988). Good faith is to be determined on a case by case basis. In re Sherman, 67 F.3d 1348, 1355 (8th Cir. 1995). "[A] transferee does not act in good faith when he has sufficient knowledge to place him on inquiry notice of the debtor's possible insolvency."(FN5) In re Sherman, 67 F.3d at 1355.

Whether Freidson or Perlco qualify as good faith purchasers of the GE property, presents questions of material fact. Such facts include their knowledge as to Butler's interest in the Jero partnership II, AIC of Minnesota, AIC of Colorado, and Butler's personal connection with the GE property; the Defendants' knowledge of Butler's bankruptcy; the process of the title investigation; and, other information surrounding the Freidson and Perlco transaction involving the GE property. Therefore, summary judgment is not appropriate.

III

CONCLUSION

Based on the foregoing, IT IS HEREBY ORDERED THAT:

1. Plaintiff's motion for summary judgment, on the limited issue of Gerald Butler's interest in the GE property at the time of filing for bankruptcy, is GRANTED. Plaintiff shall have judgment that Gerald Butler owned the equitable interest in the GE property at filing of his bankruptcy case No. 93-34300.

2. Defendants' motion for summary judgment is DENIED. LET JUDGMENT BE ENTERED ACCORDINGLY, on paragraph 1 above.

Dated: December 26, 1996 By the Court:

Dennis D. O'Brien
Chief United States Bankruptcy Judge

(FN1) The transaction was termed a "lease" because there were outstanding property taxes, and the property could not be transferred free and clear. The "lease" provided Freidson and Perlco an option to purchase the property for $100 after all delinquent real estate taxes had been paid.

(FN2) Mr. Butler did not schedule an interest in the property in the bankruptcy case.

(FN3) The Goldetsky proceeding was to deny Butler's discharge, and the Court discussed Butler's handling of the property as an example of a pattern of conduct designed to

fraudulently conceal his property from creditors. The assertion that AIC of Colorado was truly owned by Butler's 13 year old son was, of course, preposterous, as was the Holupchinski transaction. Mr. Holupchinski was an employee of Butler's, who paid nothing for the transfer of the interest that was conveyed to him; and, he later disavowed the interest when it became apparent that he was about to suffer a large capital loss as a result of the bank's foreclosure of the property.

(FN4) In Claflin, the trial court held that a bank had reasonably relied on the record which contained a quit claim deed, and the bank had no duty to investigate any further. The bank was required to investigate, concerning the rights of an occupant of the property. The bank was not entitled to simply rely on the word of the quit claim deed holder as to why some one else was living on the property.

(FN5) A company acquiring a mortgage from a partnership was not protected by the Recording Act, because it had reasonable cause to believe that the partners were insolvent at the time of recordation of the mortgage. In the Matter of Deedle-Whiton Co., 132 F.Supp. 558, 561 (D. Minn. 1955).