

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re: BKY 4-93-439

ROGER A. HANSON AND LORI L.
HANSON,

Debtors.

EDWARD W. BERGQUIST, TRUSTEE OF
THE BANKRUPT ESTATE OF ROGER A.
HANSON AND LORI L. HANSON,

ADV 4-93-102

Plaintiff,

-v.-

MARGARET A. KINNEY,
Defendant.

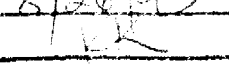
MEMORANDUM ORDER GRANTING
PLAINTIFF'S MOTION FOR SUMMARY
JUDGMENT AND DENYING
DEFENDANT'S MOTION FOR SUMMARY
JUDGMENT

At Minneapolis, Minnesota, August 26, 1993.

The above-entitled matter came on for hearing before the undersigned on the 12th day of August, 1993, on cross-motions for summary judgment. Appearances were as follows: Edward Bergquist as and for the trustee, and Neil Simmons for the defendant.

UNDISPUTED FACTS

On April 29, 1992, defendant Margaret Kinney ("Kinney") sold the debtors a restaurant business that included both real and personal property. The sale was financed through a contract for deed ("Contract") for the purchase price of \$112,000. As noted in paragraph 4 of the Contract, the purchase price included personal property valued at \$28,000. Paragraph 20 of the Contract provides: "Purchasers shall grant a security interest in equipment included

NOTICE OF ENTRY AND FILING ORDER OR JUDGMENT	
Filed and Docket Entry made on	8/26/93
Patrick G. De Wane, Clerk, By	

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in the sale pursuant to Minnesota Uniform Commercial Code Secured Transactions to secure the obligations contained in paragraph 4 herein and Buyer shall execute all financing statements that Seller deems necessary to protect said security interest."

Kinney recorded a financing statement covering all equipment used in the restaurant business with the Renville County Recorder. Kinney did not directly file the financing statement with the Secretary of State.

The debtors stopped making payments on the Contract and on January 25, 1993, filed a petition for relief under chapter 7 of the Bankruptcy Code. The trustee has now brought this adversary proceeding seeking to avoid the unperfected security interest in the personal property pursuant to section 544(a)(1) of the Bankruptcy Code. The equipment and personal property at issue have been sold post-petition by agreement of the parties. The proceeds are being held in trust by Kinney's attorney in the amount of \$6,370, which does not include the proceeds from the sale of the garage. Both the trustee and Kinney have moved for summary judgment.

POSITION OF THE PARTIES

The trustee asserts that the Contract was intended to create a security interest covering personal property in favor of Kinney. Thus, Article 9 of the Uniform Commercial Code is the applicable state law. He argues that because the contract is subject to the provisions of Article 9, Kinney failed to properly perfect the security interest when she filed a financing statement with the

County Recorder as opposed to the Secretary of State. As a result, the trustee asserts he may avoid the unperfected security interest according to section 544(a)(1) of the Bankruptcy Code.

Kinney argues that Article 9 is not the applicable law. Rather, Kinney relies on Rudnitski v Seely, 452 N.W.2d 664 (Minn. 1990), which held that cancellation of a contract for deed entitles the vendor to recover personal goods included in the contract. Id. at 668. Further, Kinney contends a vendee of a contract for deed only has equitable title, while the vendor maintains legal title. Therefore, the debtors could not have granted Kinney a security interest in property the debtor did not own. As a result, Kinney asserts, the trustee is attempting to create greater rights in the property than the rights of the debtors.

Should Article 9 control, Kinney raises the alternative defense that the security interest was perfected when Kinney filed a financing statement with the County Recorder. She asserts that the state-wide computerized filing system which connects the County Recorder's Office to the Secretary of State's filing records has rendered the difference between filing at the County Recorder or Secretary of State of no legal significance.

DISCUSSION

Summary judgment is governed by Federal Rule of Civil Procedure 56, made applicable to this adversary proceeding by Bankruptcy Rule 7056. Federal Rule 56 provides:

The judgment sought shall be rendered forthwith 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.

Fed. R. Civ. P. 56(c). The moving party on summary judgment bears the initial burden of showing that there is an absence of evidence to support the non-moving party's case. Celotex Corp. v. Catrett, 477 U.S. 317, 325 (1986). The burden then shifts to the non-moving party to produce evidence that would support a finding in its favor. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 250-52 (1986). This responsive evidence must be probative, and must "do more than simply show that there is some metaphysical doubt as to the material fact." Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 586 (1986).

A. Applicable Law

Section 544(a)(1) of the Bankruptcy Code permits the trustee to avoid liens that may be avoided by a judicial lienholder as of the date of the filing of the petition. 11 U.S.C. § 544(a)(1). Thus, the trustee obtains all the rights under state law of a hypothetical creditor with a lien on all property of the debtor.

The primary issue is what state law is applicable. I conclude that UCC Article 9 is the relevant law. Section 336.9-102 provides:

(1) Except as otherwise provided in section 336.9-104 on excluded transactions, this article applies

(a) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper or accounts;

* * *

(2) This article applies to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security. This article does not apply to statutory liens except as provided in section 336.9-310.

(3) The application of this article to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this article does not apply.

Minn. Stat. § 336.9-102 (1992) (emphasis added). In ascertaining whether the parties intended to create a security interest, it is not the subjective intent that is determinative. Vacura v. Haar's Equip., Inc., 364 N.W.2d 387, 392 (Minn. 1985). Rather, courts must also look objectively to the facts and the effects of the parties' actions. In re Keydata Corp., 18 B.R. 907, 910 (Bankr. D. Mass. 1982).

It is clear on both an objective and a subjective basis that the debtors and Kinney intended to create a security interest in the personal property. First, paragraph 20 of the Contract explicitly states that the debtors grant Kinney a security interest in the property.¹ Second, Kinney made efforts to perfect the interest when she filed the financing statement. Unfortunately for Kinney, it was filed in the incorrect place. I am not persuaded by

¹ Likewise, in Matter of Equitable Dev. Corp., 617 F.2d 1152 (5th Cir. 1980), a contract provided that "this is an assignment of certain property to secure the payment of a debt and shall be governed by the Uniform Commercial Code." Id. at 1155. The Fifth Circuit concluded that the parties intended to create a security interest. Further, the nature of the transaction did not change its character as a security arrangement merely because real property was assigned as collateral and the contract involved the purchase of land. Id. at 1156.

Kinney's argument that the purpose of paragraph 20 was to serve as notice that the equipment was sold on a contract for deed and that it could not be resold by the debtors until they satisfied the Contract.

Nor am I persuaded by Kinney's assertion that Rudnitski v. Seely, 452 N.W.2d 664 (Minn. 1990) is controlling. Rudnitski merely holds that cancellation of a contract for deed entitles the vendor to recover personal goods included in the contract. Id. at 668. In the present case, there is no indication that the Contract was actually cancelled. In Minnesota, a vendor may terminate a contract for deed after default by serving a notice upon the vendee and then waiting a specific time period. See Minn. Stat. § 559.21 (1992). Only after the statutory cancellation is the vendee's interest extinguished. See In re Crawley, 53 B.R. 40, 43 (Bankr. D. Minn. 1985) (noting that a debtor's contract for deed interest was terminated when the appropriate time expired under the statute).² Because the contract was not cancelled, the debtors maintained an equitable interest in the personal property. In re Shuster, 784 F.2d 883, 884 (8th Cir. 1986). Under the Bankruptcy

² Kinney cites Crawley for the proposition that a bankruptcy proceeding cannot bar a contract for deed vendor from cancelling the contract and receiving the property. Kinney's reliance is misguided. In Crawley, the vendor served the debtor with a cancellation notice prior to the debtor's filing of a bankruptcy petition. The vendors then filed a motion for relief from the automatic stay to complete the contract for deed cancellation. Crawley, 53 B.R. at 42. In denying the motion, the court merely stated that the cancellation required no more action on behalf of the vendors, except for allowing the statutory time to expire. Id. at 43.

Code, equitable interests of the debtor unquestionably constitute property of the estate. 11 U.S.C. § 541(a)(1).

Finally, Kinney contends that the trustee cannot have greater rights in the property than the debtor had. This reasoning is flawed in that the trustee oftentimes does obtain greater rights than the debtor under section 544 of the Bankruptcy Code. Specifically, the strong-arm provisions make it clear that the rights of a hypothetical lien creditor can defeat the rights of a seller that fails to perfect a security interest, even though the debtor could not do the same.

B. Perfection of the Security Interest

Because Article 9 is applicable, the next issue is whether Kinney perfected the security interest so as to preclude the trustee from asserting rights under section 544(a)(1) of the Bankruptcy Code. The UCC provides that an unperfected security interest is subordinate to the rights of a lien creditor. Minn. Stat. § 336.9-301(1)(b) (1992). In Minnesota, a security interest in equipment is perfected by filing the statement with the Secretary of State. Minn. Stat. § 336.9-401(1)(c) (1992). An improper filing results in an unperfected interest.

The issue is not whether Kinney directly filed the statement with the Secretary of State, for she did not. The issue raised is whether the filing at the County Recorder was sufficient in light of the computerized network system. I conclude that it was not and that Kinney must have filed the statement with the Secretary of State to be perfected.

Pursuant to section 336.9-411, the Secretary of State has authority to implement a computerized filing system to "accumulate and disseminate information" relative to financing statements. Minn. Stat. § 336.9-411 (1992). While the statute is silent concerning its effect on UCC section 336.9-401, the purpose of the system appears to be to check liens, not to perfect them. Section 336.9-401 is very precise as to the correct place of filing for every type of security interest. To adopt Kinney's argument that the distinction is obsolete in light of the computerized network would render section 336.9-401 meaningless. Absent clear language indicating such an effect, I cannot ignore the plain language of section 336.9-401.

CONCLUSION

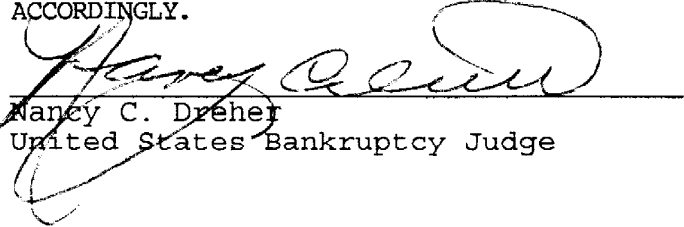
ACCORDINGLY, IT IS HEREBY ORDERED:

1. Defendant's motion for summary judgment is DENIED.
2. Plaintiff's motion for summary judgment is GRANTED.

Defendant's interest in the personal property sold to the debtors, and the proceeds from the sale thereof, may be avoided; and

3. Defendant's attorney shall turn over to the plaintiff the entire proceeds of the sale of the property in the amount of \$6,370.84.

LET JUDGMENT BE ENTERED ACCORDINGLY.


Nancy C. Dreher
United States Bankruptcy Judge