

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF INDIANA
FORT WAYNE DIVISION

IN RE: CASE NO. 06-11677)
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U AGGA)
DON MA NGAY)
)
Debtors)
)
)
YVETTE GAFF KLEVEN)
)
Plaintiff)
)
vs.) PROC. NO. 06-1484
)
DEUTSCHE BANK)
)
Defendant)

DECISION

At Fort Wayne, Indiana, on July 31, 2007

By this adversary proceeding, the plaintiff/trustee has asked the court to avoid a land contract between the debtors, as buyers, and their seller, the Secretary of Veterans Affairs, which the Secretary subsequently assigned to the defendant, Deutsche Bank. The trustee argues that the land contract can be avoided because it was not properly acknowledged before it was recorded. The matter has been submitted to the court for a decision on the parties' stipulations of fact and the briefs of counsel.

The debtors purchased the property commonly known as 6331 Amarillo Drive, Fort Wayne, Indiana, from the Secretary of Veterans Affairs pursuant to an installment contract. The contract was signed by the debtors and the Secretary of Veterans Affairs, and although it was also notarized it does not identify who appeared before the attesting official. The Secretary subsequently conveyed

the property to the defendant, pursuant to a special warranty deed, and assigned its rights under the land contract to it. Both the land contract and the deed to the defendant have been recorded, but the assignment of the land contract has not been. Title to the property remains vested in the bank. Prior to the debtors' bankruptcy, the bank commenced foreclosure proceedings in the Allen Circuit Court and successfully reduced its claim to judgment.

The powers that bankruptcy trustees have by virtue of § 544 are not about the rights of buyers and sellers, transferees and transferors, or debtors and creditors in relation to one another, but about the rights of third parties with regard to the transaction at issue. Here, the trustee seeks to avoid the contract between the debtors and the bank using § 544(a)(3) of the United States Bankruptcy Code, which allows her to avoid:

any transfer of property of the debtor . . . that is voidable by –

* * * *

(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)(3).

In Indiana, a bona fide purchaser takes free of any interest in real estate which is unrecorded and of which it has no constructive or actual notice. United States v. Arnol & Mildred Shafer Farms, Inc., 107 B.R. 605, 607 (N.D. Ind. 1989). See also, In re Graham, 110 B.R. 408 (S.D. Ind. 1990). The only change to this rule because of bankruptcy is that actual notice is irrelevant. 11 U.S.C. § 544(a). Instead, only the constructive notice gained by a review of the title record matters. Shafer Farms, 107 B.R. at 608. The “transfer” contemplated by § 544(a)(3) is hypothetical and acts only as a measure of the trustee’s theoretical rights. Belisle v. Plunkett, 877 F.2d 512, 516 (7th Cir. 1989),

cert. denied, Belisle v. Anzevino, 493 U.S. 893 (1989). Furthermore, because it focuses on the rights of a BFP, § 544(a)(3) is an exception to the general rule that the trustee's rights in property are no greater than those of the debtor. Through it, "[t]he estate gets what the debtor could convey under local law rather than only what the debtor owned" Id. (emphasis original).

Although the debtors' land contract with the bank was recorded, the trustee argues that the contract's acknowledgment was defective. Because of that deficiency, it did not meet the requirements of the recording statute, it was not entitled to be recorded and, under Indiana law, does not provide constructive notice to third parties. See, In re Sandy Ridge Oil Co., 510 N.E. 2d 667 (Ind. 1987) (an instrument which is not entitled to be recorded does not afford constructive notice). The trustee contends this case is substantially similar to that presented by In re Stubbs, where the defective acknowledgment on a recorded mortgage allowed the trustee to avoid the mortgage. In re Stubbs, 330 B.R. 717 (Bankr. N.D. Ind. 2006), aff'd, 2006 WL 2361814 (N.D. Ind. 2006). See also, In re Baldin, 135 B.R. 586 (Bankr. N.D. Ind. 1991). Although the present case involves a land contract rather than a mortgage, the trustee argues that under Indiana law the seller's interest in a land contract is treated similarly to the interest of a mortgagee. Upon execution of the contract, the buyer becomes the equitable owner of the property, with the seller, in effect, holding a lien upon it, which in the event of default may be foreclosed. See, Skendzel v. Marshall, 301 N.E.2d 641 (Ind. 1973). "Realistically, vendor-vendee should be viewed as mortgagee-mortgagor. To conceive of the relationship in different terms is to pay homage to form over substance." Id. at 646. Working from these propositions, the trustee argues that a contract seller is no different from a mortgagee and if a defective acknowledgment on a mortgage will allow a BFP to defeat the rights of a mortgagee, a defective acknowledgment on a land contract should allow that same BFP to defeat the rights of

a contract seller, who occupies the position of mortgagee.

While a mortgage and a land contract may be treated similarly when it comes to determining the rights of the immediate parties and the remedies for a breach, the trustee's argument pushes the analogy a bit too far. Despite their functional similarities, a mortgage and a land contract are not the same thing and when it comes to analyzing the rights of third parties – rather than those of the parties themselves – it is important to remember that fact and, in particular, to recognize who owns the property and who is transferring what to whom. Where the transaction is a land contract the legal owner is transferring equitable title to the buyer. Skendzel, 301 N.E.2d at 646. Where the transaction involves a mortgage, the legal owner is transferring a lien upon the property to the mortgagee. In both situations, it is always the legal owner of the property who is transferring an interest in it to someone else.

Section 544 only allows the trustee to avoid a “transfer of property of the debtor.” Where the debtor is the buyer, a land sale contract is not a transfer of property of the debtor. It is a transfer to the debtor. Despite all of the arguments about the importance of recognizing substance over form, there is no escaping the fact that the substance of the transaction in issue is that the debtor/buyers acquired an interest in property; they did not part with one. They were the transferees, not the transferors, and § 544(a)(3) will not allow the trustee to avoid the interest of their contract seller.

A judgment of dismissal will be entered.¹

/s/ Robert E. Grant
Judge, United States Bankruptcy Court

¹Given this conclusion, the trustee's motion to amend her complaint is moot.