



Entered on Docket  
May 20, 2008

Hon. Mike K. Nakagawa  
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT  
DISTRICT OF NEVADA

\*\*\*\*\*

In re:	)	
U.S. MORTGAGE, a Nevada corporation,	)	BK-S-06-13977-MKN
Debtor.	)	Chapter 7
<hr/>		
LENARD E. SCHWARTZER, Chapter 7 Trustee,	)	Adversary No. 07-01142
Plaintiff,	)	Date: April 16, 2008
v.	)	Time: 9:30 a.m.
MICHAEL J. HAKAN CHARITABLE REMAINDER TRUST and PACIFIC CENTRAL MORTGAGE, INC.,	)	
Defendants.	)	
<hr/>		

**MEMORANDUM DECISION ON  
CROSS-MOTIONS FOR SUMMARY JUDGMENT**

Defendants, Michael J. Hakan Charitable Remainder Trust (“MJH Trust”) and Pacific Central Mortgage, Inc. (“PCM”) filed a Motion for Summary Judgment (“MSJ”) on February 27, 2008. Plaintiff, Lenard E. Schwartzter, Chapter 7 trustee (“Trustee”) filed his Cross-Motion for Summary Judgment on February 29, 2008 (“Cross-MSJ”). The motions were heard on April 16, 2008. The appearances of counsel were noted on the record. Oral argument was presented and the matters were taken under submission.

**BACKGROUND<sup>1</sup>**

On December 20, 2006, U.S. Mortgage, a Nevada corporation (“Debtor”), filed a voluntary petition for reorganization under Chapter 11. (Dkt# 1)<sup>2</sup> On March 5, 2007, the case was converted to a Chapter 7 liquidation proceeding. (Dkt#326)

On August 29, 2007, the Trustee filed an adversary complaint against MJH Trust and PCM. (ADkt#1) An amended complaint was filed on September 25, 2007. (ADkt#7) The Trustee seeks declaratory relief regarding two parcels of real property: 4055 Buxton Road, South Euclid, Ohio (“the Euclid Property”), and 972 East 77th Street, Cleveland, Ohio (“the Cleveland Property”) (collectively “the Properties”). Title to both Properties was in the Debtor’s name on the bankruptcy petition date as the result of foreclosure proceedings.

Defendants filed their MSJ against the Plaintiff asserting that, at the time of the filing of its bankruptcy petition, the Debtor had only bare legal title but no equitable interest in the Properties. Defendants assert that they still hold the equitable interest in the Properties because the Properties were assigned to the Debtor only to service the loans for which the Properties served as collateral. As a result, Defendants assert that the Properties are excluded from the bankruptcy estate under Section 541(d). See MSJ, p.7, lines17-23.

The Trustee’s Cross-MSJ asserts that Section 544(a)(3) trumps a beneficiary’s unrecorded interest in real property under Section 541(d) and that the Properties constitute property of the Debtor’s bankruptcy estate under Section 541(a). See Cross-MSJ.

**SUMMARY JUDGMENT STANDARDS**

Rule 56 of the Federal Rules of Civil Procedure is applicable in adversary proceedings pursuant to Rule 7056. See In re Silva, 190 B.R. 889, 891 (B.A.P. 9th Cir.1995). Summary judgment is proper where “the pleadings, depositions, answers to interrogatories, and admissions

---

<sup>1</sup> In the text and footnotes of this Memorandum Decision, all references to “Section” shall be to the provisions of the Bankruptcy Code appearing in Title 11 of the United States Code, unless otherwise indicated. All references to “Rule” shall be to provisions of the Federal Rules of Bankruptcy Procedure, unless otherwise indicated.

<sup>2</sup> References in this Memorandum Decision to “Dkt#” are to documents filed in the Chapter 7 case while references to “ADkt#” are to documents filed in the adversary proceeding.

1 on file, together with the affidavits, if any, show that there is no genuine issue as to any material  
2 fact and that the moving party is entitled to a judgment as a matter of law.” Fed. R. Civ. P. 56(c).  
3 For summary judgment purposes, a fact is "material" if it might affect the outcome of the suit  
4 under the governing substantive law. See Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248  
5 (1985). The nonmoving party cannot rest upon mere denials or allegations in pleadings, but  
6 must set forth specific facts, by affidavit or otherwise, sufficient to raise a genuine issue of  
7 material fact for trial. See Celotex Corp. v. Catrett, 477 U.S. 317, 324 (1986). When a  
8 defendant moves for summary judgment, it is not necessary for the defendant to introduce  
9 evidence that negates the plaintiff’s claim. Id. at 323. Rather, its burden may be satisfied in two  
10 ways: (1) the defendant may submit evidence that demonstrates the absence of a material  
11 element of the plaintiff’s claim, or (2) the defendant may show there is no evidence to support an  
12 essential element of the plaintiff’s claim. Id. at 325.

13 **MATERIAL FACTS NOT IN DISPUTE**

14 Pursuant to the Stipulated Statement of Facts for Cross-Motions for Summary Judgment  
15 (“Stipulated Facts”) filed by Defendants on behalf of the parties (ADkt#24), the following facts  
16 are not in dispute:

- 17 1. The Debtor filed for relief under Chapter 11 of the United States Bankruptcy  
18 Code on or about December 20, 2006.
- 19 2. The Debtor’s case was converted to a case under Chapter 7 on March 2, 2007.
- 20 3. Lenard E. Schwartzer is the duly appointed and acting Chapter 7 Trustee.

21 **A. The Euclid Property.**

- 22 4. The instant adversary proceeding concerns real property located at 4055 Buxton  
23 Road, South Euclid, Ohio 44121 purchased by Jeffrey and Elizabeth Gill (the  
24 “Gills”) for the original purchase price of \$50,500.00 (the “Gill Loan”).
- 25 5. The Gill Loan was owned by MJH Trust or PCM.
- 26 6. The Debtor began servicing the Gill Loan for Defendants in or about 2002.
- 27 7. After the Debtor began servicing the Gill Loan for MJH Trust, the Gills  
28 defaulted on the Gill Loan. As a course of conduct, foreclosure on this Loan

1 involved an assignment of the Euclid Property from MJH Trust to the Debtor.

2 8. On or about July 2, 2003, the Debtor commenced foreclosure proceedings  
3 relating to the Euclid Property (the Gill Loan).

4 9. A Sheriff's Sale of the Euclid Property was held on or about March 28, 2005.

5 10. At the Sheriff's Sale on March 28, 2005, the Debtor purchased the Euclid  
6 Property for \$97,250.00.

7 11. The Sheriff's Deed for the Euclid Property was recorded over a year later,  
8 on or about July 14, 2006, showing the grantee as the Debtor.

9 12. The Euclid Property was in excessive disrepair and required significant  
10 expenditures of money to prepare the Property for sale to a third party.

11 13. MJH Trust advanced to the Debtor approximately \$41,854.10 over time to  
12 fund the Euclid Property repairs prior to the foreclosure sale.

13 14. On or about August 31, 2006, the Debtor remitted \$83,266.91 to MJH Trust  
14 for the Euclid loan. The parties have not, however, stipulated to the balance due,  
15 if any, to MJH Trust on the Gill Loan.

16 15. On or about December 20, 2006, the Debtor entered into a listing agreement  
17 for the Euclid Property with a real estate broker, Elite Realty.

18 16. Title to the Euclid Property remains in the Debtor's name.

19 17. The parties have agreed to sell the Euclid Property as soon as possible,  
20 regardless of the sales price, and hold proceeds pending further order of this  
21 Court. The parties do not believe that differences of opinion of fair market value  
22 will affect the legal issues present in this case.

23 18. The Trustee claims that the Debtor's bankruptcy estate owns the Euclid  
24 Property.

25 19. MJH Trust claims that the Euclid Property belongs to MJH Trust and that the  
26 Debtor simply holds bare title to the property as MJH Trust's agent and for MJH  
27 Trust's benefit. MJH Trust claims that as such, title to the property or proceeds of  
28 sale should be conveyed to MJH Trust, and that once the Euclid Property is sold

1 to a third-party purchaser, MJH Trust should receive any amounts due and  
2 owning to it on the subject loan, and the bankruptcy estate should receive any  
3 proceeds in excess of the amounts due and owing to MJH Trust.

4 **B. The Cleveland Property.**

5 20. The instant adversary proceeding also concerns real property located at 972 E.  
6 77<sup>th</sup> Street, Cleveland, Ohio 44103 previously owned by Arlean Miles (“Miles”)  
7 with a loan (the “Cleveland Loan”).

8 21. The Cleveland Loan was originally owned by Hakan.

9 22. The Debtor serviced the Cleveland Loan for Hakan.

10 23. After the Debtor began servicing the Loan for Hakan, Miles defaulted on  
11 the Cleveland Loan. As a course of conduct, foreclosure on the Cleveland Loan  
12 involved an assignment of the property from Hakan to the Debtor.

13 24. After Miles default, the Debtor commenced foreclosure proceedings relating to  
14 the Cleveland Property.

15 25. A Sheriff’s Sale of the Cleveland Property was held on April 3, 2006.

16 26. At the Sheriff’s Sale on April 3, 2006, the Debtor purchased the Cleveland  
17 Property for approximately \$33,334.00.

18 27. The Sheriff’s Deed for the Cleveland Property was recorded on or about July 5,  
19 2006, showing the grantee as the Debtor.

20 28. No remittance was ever made to Hakan in connection with the foreclosure sale of  
21 the Cleveland Property.

22 29. Title to the Cleveland Property remains in the Debtor’s name.

23 30. Regardless of the sales price, the parties have stipulated to sell the Cleveland  
24 Property as soon as possible and hold proceeds pending further order of this  
25 Court.

26 31. The Trustee claims that the Debtor’s bankruptcy estate owns the Cleveland  
27 Property.

28 32. Hakan claims that the Cleveland Property belongs to Hakan and that the

1 Debtor simply holds bare title to the property as Hakan's agent and for Hakan's  
2 benefit. Hakan claims that as such, title to the property or proceeds of sale should  
3 be conveyed to Hakan, and that once the Cleveland Property is sold to a third-  
4 party purchaser, Hakan should receive any amounts due and owing to it on the  
5 subject loan, and the bankruptcy estate should receive any proceeds in excess of  
6 the amounts due and owing to Hakan. Additionally, the parties do not believe that  
7 their differences of opinion regarding the fair market value of the Cleveland  
8 Property will affect the legal issues in this case.

9 The stipulated facts are incorporated by reference into the cross motions.

10 **DISCUSSION**

11 The parties agree that the outcome of this adversary proceeding turns solely on whether  
12 the Trustee may assert his status as a hypothetical bona fide purchaser of real property to avoid  
13 Defendants' interest in the Properties under Section 544(a)(3).

14 Section 541 of the Bankruptcy Code sets forth the assets of the petitioner that constitute  
15 property of the bankruptcy estate. As relevant to this proceeding, it provides:

16 "The commencement of a case under...this title creates an estate.  
17 Such estate is comprised on all the following property, wherever  
18 located and by whomever held: (1)...all legal or equitable interests  
19 of the debtor in property as of the commencement of the case, (2)  
20 [a]ll interests of the debtor and the debtor's spouse in community  
21 property as of the commencement of the case..., [and] (3) [a]ny  
22 interest in property that the trustee recovers under section...550  
23 ...of this title."

24 11 U.S.C. § 541(a)(1,2, and 3).

25 Section 541(d) provides as follows:

26 "Property in which the debtor holds, as of the commencement of  
27 the case, only legal title and not an equitable interest, such as a  
28 mortgage secured by real property, or an interest in such a  
mortgage sold by the debtor but as to which the debtor retains legal  
title to service or supervise the servicing of such mortgage or  
interest, becomes property of the estate under subsection (a)(1) or  
(2) of this section only to the extent of the debtor's legal title to  
such property, but not to the extent of any equitable interest in  
such property that the debtor does not hold."

11 U.S.C. § 541(d).

1 Section 544(a)(3) provides in pertinent part that:

2 “The trustee shall have, as of the commencement of the case, and  
3 without regard to any knowledge of the trustee or of any creditor,  
4 the rights and powers of, or may avoid any transfer of property of  
5 the debtor or any obligation incurred by the debtor that is voidable  
6 by- ...(3) a bona fide purchaser of real property, other than fixtures,  
7 from the debtor, against whom applicable law permits such  
8 transfer to be perfected, that obtains the status of a bona fide  
9 purchaser and has perfected such transfer at the time of the  
10 commencement of the case, whether or not such a purchaser  
11 exists.”

12 11 U.S.C. § 544(a)(3). Section 544(a) commonly is referred to as the “strong arm clause” since  
13 the bankruptcy trustee is accorded legal status that the pre-bankruptcy debtor would not have  
14 possessed. See 4 Collier on Bankruptcy, ¶ 544.03 (Alan N. Resnick & Henry J. Sommer eds.,  
15 15th ed. rev.).

16 Finally, Section 550 provides in pertinent part as follows:

17 “...to the extent that a transfer is avoided under section 544...of this  
18 title, the trustee may recover, for the benefit of the estate, the  
19 property transferred, or, if the court so orders, the value of such  
20 property, from (1) the initial transferee of such transfer or the  
21 entity for whose benefit such transfer was made; or (2) any  
22 immediate or mediate transferee of such initial transferee.”

23 11 U.S.C. § 550(a)(1 and 2).<sup>3</sup>

24 In National Bank of Alaska v. Erickson (In re Seaway Express Corp.), 912 F.2d 1125  
25 (1990), the Ninth Circuit indicated that Section 544(a)(3) applies in circumstances where no  
26 prepetition transfer of assets by the debtor has taken place. 912 F.2d at 1128-1130. By its  
27 express terms, Section 544(a)(3) grants a bankruptcy trustee the rights and powers of a bona fide  
28 purchaser of real property of the debtor. Thus, is it immaterial whether the loan servicing  
arrangements between the Debtor and the MJH Trust or Hakan ever effected a transfer of an  
interest in the Properties from the Debtor to the Defendants.

State law determines whether a hypothetical bona fide purchaser will defeat competing  
claims to real property owned by the debtor at the commencement of the bankruptcy case. See  
Seaway Express, supra, 912 F.2d at 1128, citing In re Tleel, 876 F.2d 769, 772 (9<sup>th</sup> Cir. 1989). A

---

<sup>3</sup> Section 551 further provides that “Any transfer avoided under section...544...of this  
title, is preserved for the benefit of the estate but only with respect to property of the estate.”

1 trustee's rights as a hypothetical bona fide purchaser are limited by any constructive or inquiry  
2 notice such purchaser would have under state law. See Taxel v. Chase Manhattan Bank (In re  
3 Deuel), 361 B.R. 509, 514 (B.A.P. 9<sup>th</sup> Cir. 2006). There is nothing in the chain of title between  
4 the foreclosure sale deeds recorded with respect to the Properties and the commencement of the  
5 Debtor's case setting forth Defendants' asserted equitable interests in the Properties. There also  
6 is no dispute in this case that the Defendants were not occupying the Properties on the  
7 bankruptcy petition date so as to put a purchaser on inquiry notice. Compare In re Costell, 75  
8 B.R. 348, 352-53 (Bkrcty.N.D.Ohio 1987)(former spouse's possession is consistent with record  
9 title and does not put bankruptcy trustee on inquiry notice under Ohio law of interest granted  
10 under divorce decree). See also Robertson v. Peters (In re Weisman), 5 F.3d 417 (9<sup>th</sup> Cir.  
11 1993)(constructive or inquiry notice based on possession of real property may defeat a trustee's  
12 bona fide purchaser status under California law)<sup>4</sup>.

13 Both Properties in this adversary proceeding are located in the State of Ohio. The  
14 trustee's strong arm status as a bona fide purchaser is therefore measured by Ohio law. See In re  
15 Anderson, 266 B.R. 128, 132 (Bkrcty.N.D.Ohio. 2001). See also In re Nowak, 104 Ohio St.3d  
16 466, 820 N.E.2d 335, 338 (Ohio S.Ct. 2004). Section 5301.25 of the Ohio Revised Code  
17 provides that "[A]ll deeds, land contracts....., and instruments in writing....., shall be recorded in  
18 the office of the county recorder of the county in which the premises are situated. Until so  
19 recorded or filed for record, they are fraudulent insofar as they relate to a subsequent bona fide  
20

---

21 <sup>4</sup> In Siegel v. Boston (In re Sale Guaranty Corporation), 220 B.R. 660 (B.A.P. 9<sup>th</sup> Cir.  
22 1998), the defendants in a Section 554(a)(3) action retained possession of the properties  
23 transferred to the debtor, thereby placing the trustee on inquiry notice of their claim equitable  
24 interests. As a result, the trustee was not a hypothetical bona fide purchaser under California  
25 law. Defendants' reliance on Sale Guaranty Corporation, see Defendants' Reply at 2:20 to 3:12,  
26 therefore is misplaced. Similarly, in Hewitt v. Glaser Land & Livestock Company, 97 Nev. 207,  
27 626 P.2d 268 (Nev.1981), the holder of a quit claim deed brought a quiet title action against the  
28 purchaser of the same real property at a sheriff's sale. Even though the property was improperly  
described in the sheriff's certificate of sale that was recorded prior to the quit claim deed, the  
plaintiff was on inquiry notice by the presence of the purchaser's name in the grantee-grantor  
index of the county records. For that reason, the recipient of the quitclaim deed was not a bona  
fide purchaser under Nevada law. Defendants' reliance on Hewitt, see Defendants' Reply at  
2:14-19 and 4:14-16, also is misplaced.



1 purchase having, at the time of purchase, no knowledge of the existence of that former deed, land  
2 contract or instrument.” See Ohio Rev. Code § 5301.25(A). See In re Nowak, supra. Under  
3 Ohio law, an unrecorded equitable interest in real property, such as a resulting or constructive  
4 trust, will not attach to property acquired by a bona fide purchaser. See Union Savings & Loan  
5 Association v. McDonough, 101 Ohio App.3d 273, 655 N.E.2d 426, 428 (Ohio 1995).

6 Defendants argue that the Debtor possessed only bare legal title to service the loans  
7 secured by the Properties as of the commencement of the case. As a result, they argue that the  
8 equitable interest in the Properties remain with the Defendants pursuant to Section 541(d).  
9 Defendants primarily rely on two bankruptcy court decisions previously entered in this judicial  
10 district, In re Mortgage Funding, Inc., 48 B.R. 152, 153 (Bkrcty.D.Nev.1985) and In re Lemons  
11 & Associates, Inc., 67 B.R. 198, 210 (Bkrcty.D.Nev.1986). See MSJ at 5:24 to 7:17.

12 After the Mortgage Funding and Lemons & Associates cases were decided, however, the  
13 Ninth Circuit issued its decision in Seaway Express. The Trustee argues that the Mortgage  
14 Funding and Lemons & Associates decisions are factually distinguishable since both involved  
15 the assignment of secured notes from a mortgage broker to investors. In contrast, the instant  
16 case involves the assignment of a secured interest from an investor to the Debtor. The Trustee  
17 agrees that Section 541(d) was intended by Congress to protect the integrity of the secondary  
18 mortgage market. See Trustee’s Opposition to Defendants’ Motion for Summary Judgment  
19 (“Trustee’s Opposition”)(ADkt# 29) at 3:15-17, citing Mortgage Funding, supra, 48 B.R. at 155.  
20 However, the Trustee argues that the present case involves the transfer of interests in real  
21 property which are controlled by the decision in Seaway Express. See Trustee’s Opposition at  
22 3:17-20.

23 In Seaway Express, the court followed the Seventh Circuit’s reasoning in Belisle v.  
24 Plunkett, 877 F.2d 512 (7th Cir. 1989), cert. denied, 493 U.S. 893 (1989), and concluded that  
25 Section 541(d) does not limit a trustee’s powers over real property under Section 544(a)(3).  
26 Seaway Express, supra, 912 F.2d at 1128-29. Its conclusion was clear:

27 “We follow the majority rule. When a creditor claims an inchoate  
28 equitable interest in real property owned by the debtor at the  
commencement of the case, which interest is not evidenced by a

1 recorded instrument and not yet granted by a state court, the trustee  
2 as a bona fide purchaser prevails.”

3 Id. (citations omitted.) Defendants argue that they have an equitable interest in the property.  
4 See MSJ at 7: 21-23. However, as stipulated by the parties, title to the Properties remain in the  
5 name of the Debtor and no assertion is made that a valid judgment or an instrument evidencing  
6 Defendants’ asserted equitable interest has been recorded. Under Ohio law, an unrecorded  
7 equitable interest in real property does not supersede the interests of a bona fide purchaser. Thus,  
8 under Seaway Express, the Trustee’s strong arm powers under Section 544(a)(3) prevail over  
9 Section 541(d).<sup>5</sup>

10 Moreover, because Section 541(d) applies only to property of the estate specifically  
11 encompassed by Section 541(a)(1) and Section 541(a)(2), it simply does not limit property of the  
12 estate encompassed by Section 541(a)(3). The latter provision references, inter alia, “any  
13 interest in property” that a trustee recovers under Section 550. Section 550 includes interests  
14 recovered through exercise of a trustee’s strong arm powers under Section 544. The Court will  
15 not rewrite Section 541(d) to apply to matters encompassed by Section 541(a)(3). For this  
16 additional reason, the Court concludes that Section 541(d) does not apply in this adversary  
17 proceeding.

### 18 CONCLUSION

19 Based upon the foregoing, Defendants’ MSJ is hereby denied and Plaintiff’s Cross-MSJ  
20 is hereby granted. A separate order has been entered concurrently herewith.

21 Copies noticed through ECF to:

22 BONNIE JEAN BOYCE boycelaw@xmission.com

23 JASON A. IMES bkfilings@s-mlaw.com

24 JEANETTE E. MCPHERSON bkfilings@s-mlaw.com;info@s-mlaw.com

25  
26 <sup>5</sup> See also Tort Claimants Committee v. Roman Catholic Archbishop of Portland in  
27 Oregon, etc. (In re Roman Catholic Archbishop of Portland), 335 B.R. 868 (Bkrcty.D.Ore.  
28 2005)(hypothetical bona fide purchaser under Oregon law did not have constructive or inquiry  
notice of unrecorded equitable interests; committee asserting avoiding power under Section  
544(a)(3) prevailed over claim of Section 541(d) exclusion).

1 LENARD E. SCHWARTZER trustee@s-mlaw.com, nv17@ecfbis.com;wholland@s-  
2 mlaw.com;cnadolsky@s-mlaw.com

3  
4 and sent to BNC to:  
5 All parties on BNC mailing list

6  
7 ###  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28