

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
EASTERN DIVISION

IN RE:

RICHARD F. GOSSUM and
SANDRA A. GOSSUM,

BK #92-11057-WHB
Chapter 7

Debtors.

FREIDA WILSON,

Plaintiff,

v.

Adversary Proceeding
No. 93-1044

RICHARD F. GOSSUM,
SANDRA A. GOSSUM and
MICHAEL T. TABOR, Chapter
7 Trustee,

Defendants.

MEMORANDUM OPINION AND
ORDER ON COMPLAINT TO DETERMINE THE
VALIDITY, PRIORITY AND EXTENT OF THE INTEREST
OF PLAINTIFF AND TRUSTEE IN PROPERTY

In this proceeding, the Court is faced with resolution of the application of Bankruptcy Code Sections 544(a) and 550(b) and (d). At issue is whether the trustee may avoid and recover the value of real property transferred by the debtors without a recorded deed. The following constitutes findings of fact and conclusions of law pursuant to F.R.B.P. 7052. The plaintiff originally filed a motion to require the trustee to abandon his interest in the property and the trustee responded to the

motion by relying on 11 U.S.C. §544(a). By consent an expedited trial was conducted and the motion was converted to an adversary proceeding.

SUMMARY OF FACTS

The record reflects that Richard and Sandra Gossum ("debtors") initiated their bankruptcy case with the filing of a voluntary Chapter 11 petition on May 13, 1992. Attempts to reorganize were unsuccessful and the case was converted to Chapter 7. Mr. Michael T. Tabor was named case trustee ("trustee").

It was subsequently discovered that in 1979, the debtors entered into a transaction to sell their residence located at 400 Third Street, Fulton, Kentucky, to James and Freida Bushart. The parties agreed that the Busharts would pay Mr. Gossum the equity in his property, approximately \$60,000.00, and would assume the approximate \$47,000.00 balance of the mortgage loan due First Federal Savings and Loan Association of Fulton, Kentucky. See Tr. Ex. 6. According to Freida Bushart Wilson's¹ testimony, Mr. Gossum allowed the Busharts time to sell their home before paying his equity of approximately \$60,000.00 and he took a note for the equity until the Busharts sold their prior residence in 1980. See also, Tr. Ex. 11, 1980 Income Tax Return. The parties' agreement was reduced to writing. The documents, prepared by an attorney, were signed by the Gossums and Mr. Bushart. At the same time, Mr. Gossum gave the First Federal payment book to Mr. Bushart. Tr. Ex. 6. Mrs. Wilson, the plaintiff, did not sign the documents evidencing the transaction but she was present at the signing.

After signing the documents and receiving payment for his equity, Mr. Gossum assumed that he had sold the property. He made no further loan, tax or insurance payments on the property.

¹ Since the transaction occurred, Mr. and Mrs. Bushart have divorced and Mrs. Bushart has remarried.

Indeed, he did not even list the property on his bankruptcy petition. However, no deed, land sales contract or other written evidence of the transaction was ever recorded.

Subsequently, Mr. and Mrs. Bushart were divorced and Mr. Bushart quit claimed his interest in the property to the plaintiff on April 15, 1993. Tr. Ex. 3. In February or March of 1993, she began efforts to refinance the balance of the mortgage loan due and discovered that there was no recorded deed. It is the case trustee's position that he has an interest in the property that is superior to that of the plaintiff.

DISCUSSION

Upon commencement of a bankruptcy case, an estate is created comprised of all legal and equitable interests of the debtor in property at the time of filing. 11 U.S.C. §541(a). Moreover, the bankruptcy trustee is vested with certain "strong-arm" powers that grant the trustee the status, rights and powers of a judicial lien creditor as to the debtor's property interests at commencement of the case. 11 U.S.C. §544(a)(1) and (2).

Under these provisions and Kentucky law, the absence of a recorded deed or other instrument transferring the debtor's property results in the debtor retaining legal title. See Ky. Rev. Stat. Ann. §382.080; 382.100; Sebastian v. Floyd, 585 S.W. 2d 381 (Ky. 1979). In addition, the trustee's status as a judicial lien creditor renders the estate's interests superior to that of any unperfected lien or interest holder. 11 U.S.C. §544(a)(1) and (2); Ky. Rev. Stat. Ann. 382.080. Consequently, the transfers to Mr. Bushart and Mrs. Wilson may be avoided by the trustee under the authority of §544(a)(1) and (2).

The inquiry does not end here however because in order to recover property or its value pursuant to such an avoidance, adherence to the provisions of 11 U.S.C. §550 governing the "Liability of transferee of avoided transfer" is required. In pertinent part, this section provides that:

(a) . . . to the extent that a transfer is avoided under section 544, . . . , the trustee may recover, for the benefit of the estate, the property transferred, or if the court so orders, the value of such property, from

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(1) the initial transferee . . . or the entity for whose benefit such transfer was made; or

(2) any immediate or mediate transferee of such initial transferee.

(b) The trustee may not recover . . . from -

(1) a transferee that takes for value, . . . in good faith and without knowledge of the voidability of the transfer avoided; or

(2) any immediate or mediate good faith transferee of such transferee.

(c) The trustee is entitled to only a single satisfaction under . . . this section.

(d)(1) A good faith transferee from whom the trustee may recover under . . . this section has a lien on the property recovered to secure the lesser of -

(A) the cost, to such transferee, of any improvement made after the transfer, less the amount of any profit . . . accruing to such transferee from such property; and

(B) any increase in the value of such property as a result of such improvement

(2) In this subsection, "improvement" includes -

(A) physical additions or changes to the property transferred;

- (B) repairs to such property;
- (C) payment of any tax on such property;
- (D) payment of any debt secured by a lien on such property that is superior or equal to the rights of the trustee; and
- (E) preservation of such property.

From the facts presented, the Court specifically finds that the trustee should be limited to a monetary recovery that is capped by the value of the property. A recovery of the actual real property would not be effective as the trustee would be forced to sell the property to satisfy all liens against it.

Although the plaintiff is obviously a §550(a) transferee of the property at issue, it is uncontroverted and the Court expressly finds that the plaintiff here is a good faith transferee who took the property without knowledge of the voidability of the transfer. In addition, it is undisputed that the purchase price of the property was \$107,500.00 and that with her ex-husband the plaintiff gave value for the property in that they:

- (a) became obligated on a promissory note to Mr. Gossum for approximately \$60,000.00, which was the value of Mr. Gossum's equity in the property;
- (b) paid that note in full when their other home was sold; and
- (c) assumed the \$47,000.00 mortgage loan balance, subsequently paying \$20,000.00 in principal thereon.

Moreover, there is evidence that actual documents were signed and that Mr. Bushart may have possession of those documents while he refused to assist Mrs. Wilson in this litigation. See Stipulations . . . Richard Gossum. The Gossums and Busharts acted for fourteen years as if the property belonged to the Busharts.

Accordingly, the plaintiff appears to qualify as a good faith transferee pursuant to §550(b) from whom the trustee may not obtain a recovery. There is a factual basis for the Court to find Mrs. Wilson to be a good faith immediate transferee of the initial transferee Mr. Bushart and Mr. Bushart to be a good faith transferee taking the property for value. 11 U.S.C. §550(b). As such the Trustee would be prohibited from any recovery from Mrs. Wilson. In the alternative, assuming that Mrs. Wilson is a good faith transferee from whom the trustee may recover, §550(d) limits that recovery to the excess over a lien held by the good faith transferee.

The plaintiff will retain a lien that will limit any such recovery to the value of the property that exceeds the cost of any "improvement" provided by the plaintiff under §550(d). "Improvement" for purposes of this section is defined broadly at §550(d)(2). The evidence presented at the hearing on this matter demonstrates that the plaintiff made improvements within the statutory definition.

The fair market value of the property established by the plaintiff owner's undisputed testimony is \$115,000.00. The purchase price in 1979 when the property was transferred by the Gossums was \$107,500.00. According to the plaintiff, since the September, 1979 transfer she and her ex-husband paid the approximate \$60,000.00 promissory note due Mr. Gossum for his equity and approximately \$20,000.00 of the principal amount owed on the mortgage loan. The balance of the mortgage loan is approximately \$27,000.00. These payments qualify as payment of debts secured by liens that are "superior or equal to the rights of the trustee" as required by §550(d)(2)(D). See, Tr. Exs. 6, 7 and 11. In addition, the plaintiff has maintained insurance coverage and made property tax payments through the mortgage loan escrow account. As of July, 1992, these payments totalled \$1,986.15 annually. Further, the plaintiff and her ex-husband had the house completely insulated, rewired and recarpeted. They then installed storm windows throughout the house and

parquet wood floors in the entrance foyer and redecorated the house with new wallpaper and paint. These activities clearly qualify as physical additions and changes to the property, repairs to the property and preservation of the property within the meaning of §550(d)(2)(A), (B), (C) and (E). According to the plaintiff's 1980 income tax return, the costs of the insulation and storm windows are \$816.00 and \$303.00 respectively. Tr. Ex. 11. The plaintiff had no records of the other improvement costs.

From the evidence presented, the §550(d)(2) improvements made by the plaintiff may be summarized as follows:

- (a) \$60,000.00 for the equity note (§550(d)(2)(D));
- (b) \$20,000.00 for the mortgage loan principal reduction (§550(d)(2)(D))²;
- (c) \$1,119.99 for the insulation and storm windows (§550(d)(2)(A); and
- (d) tax and insurance payments made through the mortgage loan escrows for fourteen years with proof that the minimum amounts paid are \$1,145.00 paid in 1980, \$1,251.28 paid in 1981 and \$1,986.15 paid in 1992. Tr. Exs. 6 and 7, (§550(d)(2)(C) and (E)).

In addition, the proof demonstrates that the pay off on the mortgage loan as of August 27, 1993, was \$27,346.84 with accrual of per diem interest of \$5.96 after that date and monthly late charges of \$20.55 after September 16, 1993. At the time of the hearing on this matter, October 29, 1993, these established improvements equal \$112,649.26, approximately equal to the fair market value placed on the property by the plaintiff. In addition, the plaintiff's lien would extend to those

² This does not include the interest paid on the mortgage loan and interest would appear to also fit within the §550(d)(2)(D) definition.

other improvements on which no monetary proof was avoidable. For example, the taxes and insurance for the other eleven years would clearly consume the remaining "equity" in the property.

Accordingly, the amount of the plaintiff's §550(d) lien exceeds any value that might be available for recovery by the trustee. As such, the property would be burdensome to the estate and the trustee is directed to abandon any interest he may have in favor of the plaintiff. The recording of an abandonment order may assist in placing recorded title in the plaintiff. Plaintiff's counsel may prepare an order vesting title in the Plaintiff to the extent this Court has jurisdiction to so order.

IT IS THEREFORE ORDERED that:

1. The Trustee may avoid the unperfected transfer but the trustee's recovery is limited to a monetary recovery.
2. The plaintiff is a good faith immediate transferee from a good faith initial transferee for value, and as such, §550(b) prohibits the trustee's recovery.
3. The plaintiff is, in the alternative, entitled to a lien for improvements under §550(d) and that lien exceeds the value of the property, thus nullifying any monetary recovery by the trustee.
4. The Trustee is directed to execute an abandonment of his interest in the subject property.

SO ORDERED this 5th day of November, 1993.

WILLIAM HOUSTON BROWN
UNITED STATES BANKRUPTCY JUDGE

cc:

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