



SO ORDERED.

SIGNED this 11 day of February, 2005.

Dale L. Somers

Dale L. Somers
UNITED STATES BANKRUPTCY JUDGE

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS**

In Re:

**DAY-BY-DAY ENTERPRISES, INC.,

DEBTOR.**

**DAY-BY-DAY ENTERPRISES, INC.,
PLAINTIFF,**

v.

**FRANCHISE MORTGAGE
ACCEPTANCE CORP.,**

**GMAC COMMERCIAL MORTGAGE
CORP., et al.,
DEFENDANTS.**

**CASE NO. 04-11794
CHAPTER 11**

ADV. NO. 04-5246

MEMORANDUM OF DECISION

This proceeding is before the Court for decision following oral arguments heard on February 1, 2005. The plaintiff-debtor ("Debtor") appears by counsel Susan G. Saidian of

Redmond & Nazar, L.L.P., of Wichita, Kansas. Defendant GMAC Commercial Mortgage Corporation appears on behalf of all the remaining defendants (“GMACCM”) by counsel Michelle M. Masoner of Bryan Cave LLP of Kansas City, Missouri. The Court has reviewed the relevant pleadings, heard the arguments of counsel, and is now ready to rule.

In this proceeding, the Debtor is trying to avoid GMACCM’s mortgage on the Debtor’s leasehold interest in a Burger King restaurant as a preferential transfer covered by 11 U.S.C.A. § 547(b). The question the Court must decide is whether any circumstances existed more than 90 days before the Debtor filed for bankruptcy that were sufficient to give a hypothetical purchaser of the Debtor’s leasehold interest constructive notice of GMACCM’s mortgage. The mortgage was not filed in the public records until less than 90 days before the bankruptcy was filed, long after the Debtor gave the mortgage, so the transfer that created the mortgage is a preference that can be avoided unless events before the preference period gave similar public notice of the mortgage. The Court concludes it must reject GMACCM’s assertion that a fixture filing entered in the local county’s public records in 1997 was sufficient to give a hypothetical purchaser of the Debtor’s unrecorded leasehold interest constructive notice of GMACCM’s mortgage. Although GMACCM has asserted that a foreclosure suit it filed several weeks after recording its mortgage has some impact here, the Court believes that suit, like the mortgage recording, could not have given a hypothetical purchaser of the Debtor’s leasehold interest notice of the mortgage before the preference period began. Consequently, the Court concludes that, under § 547(e)(1), the Debtor’s transfer of the mortgage to GMACCM is deemed not to have been made until

the mortgage itself was recorded in January 2004, less than 90 days before the Debtor filed for bankruptcy, so the transfer constitutes a preference that the Debtor is entitled to avoid under § 547(b).

FACTS

The parties submitted this proceeding for decision based on facts contained in various documents admitted by stipulation, and other agreed facts.

The Debtor is one of four related companies that are involved in running restaurants under franchises granted by the Burger King Corporation (“BKC”). The Debtor operates seven Burger King restaurants in Kansas, including store number 1669 (“Store 1669”), located on East Fourth Street in Hutchinson. BKC owns the land and building used for that store. In 1994, BKC leased the premises to Douglas J. Day under a document labeled “Successor Lease or Sublease Agreement.” In 1997, BKC consented to Mr. Day’s assignment of a 50% interest in Store 1669 to his wife, and to the Days’ subsequent assignment of their interests in the store to the Debtor; these assignments included the lease for the store. None of these documents — BKC’s lease to Douglas Day, Mr. Day’s assignment to his wife, and the Days’ assignment to the Debtor (collectively, “the Lease Documents”) — has ever been recorded in the real property records in the office of the Register of Deeds for Reno County, Kansas, where Hutchinson is located.

A couple of days after the Debtor took over the Days’ interests in Store 1669, the Franchise Mortgage Acceptance Company, LLC (“FMAC”), loaned \$1 million to the

Debtor. This loan was secured by a mortgage on the Debtor's leasehold interest in Store 1669, and a security interest in essentially all personal property the Debtor had or used at or in connection with the store. FMAC soon assigned its interests in the loan and collateral to two other entities. GMAC Commercial Mortgage Corporation services the loan for these entities, and appears on their behalf in this proceeding. Because the distinctions between the interests of these entities are not relevant to this decision, the Court will simply refer to them all as "GMACCM."

Beginning in 1997, the financing statement, amendments, and continuation statement necessary to perfect GMACCM's security interest in the Debtor's personal property and keep it perfected were properly filed with the Kansas Secretary of State. A financing statement, amendments, and continuation statement necessary to protect its security interest in any of the personal property that might become fixtures were properly filed with the Reno County Register of Deeds, also beginning in 1997. The financing statement filed with the Register of Deeds stated that it was "for informational purposes only" and was a "(fixture filing)." Attachments to the financing statement indicated that the statement covered only goods located at Store 1669 and was "intended merely to protect the parties hereto from unwarranted assertions by third parties that the goods are other than personal property." The subsequent amendments and continuation statement all referred to that financing statement by the filing number assigned to it by the Register of Deeds. The Court will refer to all of GMACCM's personal property filings with the Register of Deeds as the "Fixture Filing."

GMACCM's mortgage on the Debtor's leasehold interest in Store 1669 was not recorded in the Reno County real property records until January 12, 2004. A few weeks later, on March 2, GMACCM filed a state court action against the Debtor, seeking a judgment for the balance owed on the loan, and to foreclose its mortgage on the leasehold and its security interest in the personal property. GMACCM also named BKC as a party to this suit, noting that BKC held fee simple title to the real property involved in Store 1669 and was the lessor under the Debtor's lease.

The Debtor filed a Chapter 11 bankruptcy petition on April 8, 2004, less than 90 days after GMACCM's mortgage on the leasehold was recorded with the Register of Deeds. At that time, the Debtor still owed GMACCM a little over \$830,000 on its loan. In September, the Debtor commenced this proceeding against GMACCM seeking, under 11 U.S.C.A. § 547(b), to avoid its mortgage on the leasehold as a preference. The parties have now submitted the proceeding for decision based on many of the documents referred to above, along with some additional agreed facts.

Under § 547(b), as relevant here, a Chapter 11 debtor-in-possession like the Debtor: may avoid any transfer of an interest of the debtor in property —

- (1) to or for the benefit of a creditor;
- (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
- (3) made while the debtor was insolvent;
- (4) made —
 - (A) on or within 90 days before the date of the filing of the petition; . . . and
- (5) that enables such creditor to receive more than such creditor would receive if —
 - (A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and
(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

GMACCM agrees that the Debtor's grant of its mortgage on the leasehold satisfies all these elements except those that depend on when, for purposes of § 547, the transfer is considered to have been made.

DISCUSSION

A. Section 547(e) of the Bankruptcy Code requires the Court to consider hypothetical circumstances.

If the question in this case were simply when the Debtor actually gave GMACCM the mortgage on its leasehold interest in Store 1669, the answer — in 1997, well outside the 90-day preference period — would be simple and the Debtor would lose. But subsection (e) of § 547 contains rules that complicate the answer to the question by deeming some transfers to have been “made” at a different time than one would otherwise think they had been made. The first of those rules that is relevant here, § 547(e)(2), is that “a transfer is made — (A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 10 days after, such time . . . ; [or] (B) at the time such transfer is perfected, if such transfer is perfected after such 10 days.”¹ Because the Debtor is relying on GMACCM's recording of its mortgage in January 2004 as the event that matters under § 547 while GMACCM's defense relies on events that

¹11 U.S.C.A. § 547(e)(2)(A) & (B).

occurred in 1997, the ten-day grace period mentioned in this provision is not involved in this case. If perfection of GMACCM's mortgage was delayed until the 2004 recording, the Court must consider the transfer not to have been "made" until the mortgage was later "perfected." The second relevant rule, § 547(e)(1), tells the Court how to determine when the mortgage was "perfected": "(A) a transfer of real property other than fixtures . . . is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee."² Given the argument that GMACCM is making, the Court must emphasize that the hypothetical purchaser whose interest is to be considered under this provision is one who would be buying the Debtor's interest in "such property," a phrase that refers back to the "real property *other than fixtures*" mentioned at the start of the provision; in other words, the hypothetical purchaser is not interested in any fixtures that might be attached to the property. The Court agrees with the parties that this second rule directs the Court to look to Kansas law to determine when GMACCM's mortgage was perfected.

B. Under Kansas law, constructive notice of an interest can be enough to protect it from a subsequent purchaser.

²11 U.S.C.A. § 547(e)(1)(A). The parties have also referred to § 544(a)(3), a provision that similarly authorizes a trustee or debtor-in-possession to avoid prepetition transfers that a bona fide purchaser of real property could defeat, but only if they were still unperfected when the debtor filed for bankruptcy.

Under Kansas law, the most straightforward way to protect an interest in real property from any claim made by a later purchaser of the property is to file with the proper Register of Deeds a document notifying others of the interest.³ But nobody did that for GMACCM's mortgage until January 12, 2004, and that date is too late to protect the mortgage from the Debtor's preference attack. So GMACCM asks the Court to look at earlier events that it contends serve to protect its mortgage from any potential buyer of the Debtor's leasehold interest. This leads the Court to a Kansas statute that declares unrecorded documents are not "valid, except between the parties thereto, and such as have actual notice thereof."⁴ Cases interpreting this statute have determined that a party can be deemed to have sufficient notice to take real property subject to an interest created by an unrecorded document when the circumstances are such that the party should have discovered the unrecorded interest, even though the party did not actually discover it.⁵ Probably the simplest example of this rule appears in cases holding that open and notorious possession of real property ordinarily gives constructive notice "to all the world" of the possessor's rights in the property, even though no evidence of those rights appears in the

³K.S.A. 58-2222; *see also* K.S.A. 58-2221 (every instrument affecting real estate may be filed with register of deeds of county where real estate is located); K.S.A. 58-2223 (until deposited with register of deeds, such instruments are valid only between parties to them and others with actual notice of them).

⁴K.S.A. 58-2223.

⁵*See, e.g., Schwalm v. Deanhardt*, 21 Kan. App. 2d 667, 668-69 (1995).

real property records.⁶ Here, this example makes clear that the Debtor's possession of Store 1669 was sufficient to impose a duty on any prospective buyer to ask the Debtor about its rights in the property, an inquiry that should have uncovered the unrecorded Lease Documents.

C. Why the Court must reject GMACCM's argument.

1. The hypothetical purchaser is not buying fixtures, and the Debtor's possession gives notice equivalent to recording the Lease Documents.

GMACCM argues that its Fixture Filing, coupled with the fact that the Debtor's name did not appear in the public real property records for Store 1669 except as a part of the Fixture Filing, satisfied the Kansas rule of implied or constructive notice to potential purchasers. A reasonably prudent person who intended to buy the Debtor's interest, GMACCM contends, as part of investigating the status of the title to the real property, would find the Fixture Filing, ask GMACCM about its interest in fixtures, and would be told by GMACCM that it also had the mortgage on the leasehold. But, as emphasized above, § 547(e)(1)(A) tells the Court to consider only a hypothetical purchaser of the Debtor's interest in the real property other than fixtures; by statutory declaration, such a buyer would not be concerned about GMACCM's interest in any possible fixtures. In addition, GMACCM agrees the Fixture Filing would not give notice if the Lease Documents had been recorded so the Debtor's leasehold interest appeared in the records. Because the

⁶See, e.g., *Jackson v. O'Neill*, 181 Kan. 930, 933 (1957); *Haas v. Nemeth*, 139 Kan. 252, 255-56 (1934).

Debtor's possession of the store gave notice of the Debtor's interest just as effectively as recording the Lease Documents would have — that is, Kansas law requires potential buyers to ask the party in possession about its interest in real property if the party does not appear in the title records — GMACCM's acknowledgement of this point all but concedes the fixture filing was not enough to give constructive notice of its leasehold mortgage. These considerations alone are enough to convince the Court that GMACCM's argument must be rejected.

2. *Kansas case law does not support GMACCM's position.*

Even if the Court were supposed to assume the hypothetical purchaser would be concerned about fixtures, a review of Kansas case law further solidifies the Court's conclusion that GMACCM's Fixture Filing and the failure to record the Lease Documents do not give constructive notice of GMACCM's mortgage on the leasehold. To support its view of Kansas law, GMACCM relies on *Schwalm v. Deanhardt*⁷ and *Johnson v. Williams*,⁸ two cases holding, in effect, that quitclaim deeds are so inherently suspicious that a prospective buyer of real estate must further investigate the title to the property. *Schwalm* quoted a paragraph from *Johnson* that condemned quitclaim deeds, and included the assertion that a buyer taking a quitclaim deed to real property:

must be presumed to take it with notice of all outstanding equities and interests of which he could by the exercise of any reasonable diligence obtain notice from an examination of all the records affecting the title to the

⁷21 Kan. App. 2d 667 (1995).

⁸37 Kan. 179 (1887).

property, and from all inquiries which he might make of persons in the possession of the property, or of persons paying taxes thereon, or of any person who might, from any record, or from any knowledge which the purchaser might have, seemingly have some interest in the property.⁹

GMACCM contends the Fixture Filing identified it as a party “who might . . . seemingly have some interest in the property.” The Court cannot agree.

As suggested earlier, GMACCM’s argument relies on the assumption that a potential buyer of the Debtor’s leasehold interest in Store 1669 would be concerned about goods located in the store that might be considered to be “fixtures.” Since before 1997, the Kansas version of the Uniform Commercial Code has helped real estate buyers determine what goods might qualify as fixtures. From 1997 until Revised Article 9 took effect on July 1, 2001,¹⁰ the Kansas UCC provided that:

goods are ‘fixtures’ when affixing them to real estate so associates them with the real estate that, in the absence of any agreement or understanding with his vendor as to the goods, a purchaser of the real estate with knowledge of interests of others of record, or in possession, would reasonably consider the goods to have been purchased as part of the real estate.¹¹

The 1997 Kansas UCC also provided that security interests under Article 9 could be created in goods that are fixtures or continue in goods that become fixtures, but that Article 9 security interests could not exist in “ordinary building materials incorporated into an

⁹21 Kan. App. 2d at 671 (quoting *Johnson*, 37 Kan. at 182).

¹⁰2000 Kan. Sess. L., ch. 142, § 156 (stating effective date of Revised Article 9).

¹¹K.S.A. 84-9-313(1)(a) (Furse 1996) (repealed 2000 Kan. Sess. L., ch. 142, § 155, eff. July 1, 2001).

improvement on land.”¹² Similar provisions have applied since Revised Article 9 took effect.¹³ Under these UCC provisions, a hypothetical purchaser of the Debtor’s leasehold interest in Store 1669 would know that most of the building could not be covered by the security interest described in GMACCM’s Fixture Filing. Even assuming this information was not enough to excuse the hypothetical purchaser from asking GMACCM about any goods the purchaser should have thought might be fixtures, the purchaser certainly could not be charged with a duty to ask specifically whether GMACCM had any interest in the leasehold itself. Nothing guarantees that a potential purchaser’s questions about goods that might be covered by the Fixture Filing would have spurred GMACCM to mention the separate interest created by its mortgage. Under these circumstances, the Court is convinced a Kansas state court would conclude that while a purchaser’s failure to ask GMACCM for more information about its Fixture Filing could make the purchaser lose a priority dispute with GMACCM about fixtures, the failure could not make the purchaser lose a priority dispute with GMACCM about the leasehold.

For a hypothetical purchaser satisfied to let GMACCM have priority in any possible fixtures, the only other possibly relevant notice that GMACCM’s Fixture Filing would have supplied was that the Debtor owed a debt to GMACCM secured by personal property. But

¹²K.S.A. 84-9-313(2) (1996 Furse) (repealed 2000 Kan. Sess. L., ch. 142, § 155, eff. July 1, 2001).

¹³See K.S.A. 2003 Supp. 84-9-102(41) & -9-334(a).

in *Lane v. Courange*,¹⁴ the Kansas Supreme Court decided that real property buyers' knowledge that their grantors owed a debt to a third party based on a promissory note did not impose any duty on the buyers to ask that creditor whether he had any interest in the property, an inquiry that would have disclosed the creditor's unrecorded mortgage. Similarly in this case, while GMACCM's fixture filing gave any potential purchaser notice of the debt the Debtor owed to GMACCM, it imposed no duty on the purchaser to ask GMACCM whether it might also have an interest in the Debtor's leasehold.

3. *The non-Kansas case GMACCM relies on is not persuasive.*

Besides *Schwalm* and *Johnson*, GMACCM relies on *Pereira v. Ruggerite, Inc.*,¹⁵ a decision by a federal district court applying New York state law in a bankruptcy appeal. These were the facts in that case.¹⁶ Before the debtor filed for bankruptcy, Ruggerite, Inc., sold it a restaurant, transferring the restaurant's equipment and its building lease as part of the transaction and retaining a security interest in the equipment and the lease. Ruggerite filed financing statements as permitted to perfect security interests in personal property, but filed nothing in the real property records about its interest in the lease. After the debtor filed a Chapter 7 bankruptcy, the trustee sold the restaurant, including the lease, free and clear of liens and encumbrances, and then attacked Ruggerite's claimed security interest in the lease, relying on the trustee's status under § 544(a)(3) of the Bankruptcy Code as a

¹⁴187 Kan. 645, 650 (1961).

¹⁵2004 Westlaw 324847 (S.D.N.Y. 2004).

¹⁶The district court's recitation of the facts appears at *Ruggerite*, 2004 WL 324847 at *1.

hypothetical bona fide purchaser of real property. After affirming the bankruptcy court's decision in favor of the trustee on one ground, the district court offered as an alternative the ruling that GMACCM relies on. The court said a hypothetical purchaser of a restaurant business would search not only real property records, but also personal property records to determine the status of the equipment being sold with the premises. Because Ruggerte's financing statements declared that it had a lien on the debtor's real property lease as well as on its equipment, the court said, the hypothetical purchaser would thus obtain notice that Ruggerte might have a security interest in the lease and have a duty to investigate that possibility.¹⁷

The Court declines to apply *Ruggerte's* alternative rationale here for several reasons. First, the decision was applying New York law, which may differ from the Kansas law discussed earlier in ways not revealed by the opinion. Second, the Court believes it is inappropriate to look at personal property records to determine what information should be deemed to have been available to a hypothetical purchaser of real property under either § 544(a)(3) or § 547(e)(1)(A); both provisions direct the Court to consider a buyer of only real property, not a buyer of real property plus personal property that might be considered to be related to it. (At least GMACCM, unlike Ruggerte, is relying on documents filed in the real estate records, the right place for recording interests in real property.) Third, unlike Ruggerte's financing statements, neither GMACCM's Fixture Filing nor the

¹⁷2004 WL 324847 at *5.

financing statement it filed with the Kansas Secretary of State contains any clue suggesting that GMACCM might have a lien on anything at Store 1669 other than personal property.

4. *GMACCM's reliance on its foreclosure suit is not effective.*

As a fallback position, GMACCM suggests that the Debtor is not entitled to avoid its mortgage as a preference because the Debtor's amended complaint did not mention the suit GMACCM filed to foreclose the mortgage. But that suit was filed several weeks after GMACCM recorded the mortgage, even closer to the time the Debtor filed its bankruptcy petition. While Kansas law provides that a pending lawsuit can prevent third persons from acquiring an interest in the subject matter of the suit as against the plaintiff's claims,¹⁸ and that judgments become a lien on the real property of the judgment debtor in the county where the judgment is rendered, relating back to the time the suit was filed or four months, whichever is less,¹⁹ the Court is aware of nothing in Kansas law that could make the suit serve to give a hypothetical purchaser any kind of notice of GMACCM's mortgage on the Debtor's leasehold as of any date before the suit was filed. If GMACCM's earlier recording of its mortgage was not effective to protect the mortgage from the Debtor's preference attack, and the Court noted earlier that it was not, the Court does not agree with GMACCM's belief that its later foreclosure suit might have provided any protection. For its mortgage to survive the preference attack, GMACCM must be able to direct the Court to

¹⁸K.S.A. 60-2201(a).

¹⁹K.S.A. 2003 Supp. 60-2202(a).

circumstances that existed more than 90 days before the Debtor filed for bankruptcy. The mortgage foreclosure suit simply does not fit the bill.

CONCLUSION

For these reasons, the Court concludes that, using the power created by § 547 of the Bankruptcy Code, the Debtor is entitled to avoid GMACCM's mortgage on its leasehold interest in Store 1669 as a preference.

The foregoing constitutes Findings of Fact and Conclusions of Law under Rule 7052 of the Federal Rules of Bankruptcy Procedure and Rule 52(a) of the Federal Rules of Civil Procedure. A judgment based on this ruling will be entered on a separate document as required by FRBP 9021 and FRCP 58.

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