SO ORDERED.

SIGNED this 30th day of March, 2016.

Janice Miller Karlin
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
DISTRICT OF KANSAS

In re: **Patricia K. Stamatson,**	**Case No. 13-41672** **Chapter 7**
Debtor.	
Patricia E. Hamilton, **Chapter 7 Trustee,**	
Plaintiff,	**Adversary No. 15-7046**
v.	
Jerry Livingston,	
Defendant.	

Order Denying Defendant's Motion to Dismiss

Plaintiff Patricia E. Hamilton ("Trustee"), Trustee for the Chapter 7 bankruptcy estate of Debtor Patricia K. Stamatson, seeks to avoid the postpetition transfer Debtor made of her home to Defendant Jerry Livingston ("Livingston"). The Trustee also seeks

to avoid a lien she contends Debtor granted Livingston on that property (the "Emporia property"). Livingston moves to dismiss the complaint, asserting that the Trustee has failed to state a claim upon which relief can be granted, relying on Fed. R. Civ. P. 12(b)(6).[1] He argues that because Debtor amended her Schedule C to add the Emporia property as an exempt asset after she transferred it to him, and the Trustee did not object to the amendment, the Emporia property was no longer property of the estate on the day the Trustee filed her complaint. As a result, he argues the Trustee cannot prevail on her claim under 11 U.S.C. § 549.[2] As to the Trustee's lien avoidance claim, Livingston asserts that because the Trustee has not yet, at the complaint stage, produced the purported missing mortgage, she cannot prevail as a matter of law on her § 544 claim. Because the Court finds that the Trustee's complaint states a claim under Rule 12(b)(6) for both claims, it denies Livingston's motion.

I. Factual and Procedural History

The following facts are taken from the complaint, exhibits attached thereto, and the record in this adversary proceeding and the underlying bankruptcy case.[3] Debtor and her husband purchased the Emporia property for $190,000 in August, 2012.

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[1] Fed. R. Civ. P. 12 is made applicable to bankruptcy by Fed. R. Bankr. P. 7012.

[2] All future statutory citations and all references to the "Code" are to the Bankruptcy Code, 11 U.S.C. §§ 101 *et seq*., unless otherwise stated.

[3] *See Banker v. Gold Res. Corp.* (*In re Gold Res. Corp. Secs. Litig.*), 776 F.3d 1103, 1108 (10th Cir. 2015) ("[W]e 'must consider the complaint in its entirety, as well as other sources,' including 'documents incorporated into the complaint by reference, and matters of which a court may take judicial notice.'") (quoting *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322 (2007)).

Livingston paid the $188,306.61 required to close the sale via a cashier's check dated August 9, 2012.

Contemporaneously with the closing, someone apparently notified the Armed Forces Insurance Exchange to add the newly acquired Emporia property to Debtor's insurance policy. Effective August 10, 2012, the insurance policy on the Emporia property listed Debtor and her spouse as owners and Livingston as "mortgagee."[4] When Debtor filed her bankruptcy petition sixteen months later, on December 12, 2013, she indicated the Emporia property was her residence and also listed it on Schedule A ("Real Property"), noting it had a fair market value of $169,900 with a "$0.00" secured claim. At this time, she elected not to exempt the Emporia property (or any other real estate), but did exempt many items of personal property on Schedule C ("Property Claimed as Exempt").

Debtor originally listed Livingston as an unsecured creditor on Schedule F ("Creditors Holding Unsecured Nonpriority Claims") with a claim of $200,000. She included the following explanation in the column that asked for the date she incurred the Livingston debt and the consideration for the claim: "11/2013 Personal Loan/Creditor loaned the Debtor and her husband the money to purchase their home. There is no promissory note."[5]

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[4] Adversary Compl., Ex. D.

[5] Main bankruptcy Case No. 13-41672, Doc. 1, Schedule F, Creditor # 14 at p. 23. The Court cannot explain the discrepancy between the "11/2013" date and the date of Livingston's cashier's check dated August 2012, or the $200,000 balance due compared to the $188,306.61 check, especially when coupled with Debtor's Amended Statement of Financial Affairs—made under penalty of perjury—that "within 90 days immediately

On December 30, 2013, eighteen days after filing her Chapter 7 petition, Debtor and her husband executed a promissory note to Livingston in the amount of $200,000 at 4.25% interest "for the property purchased" in Emporia, Kansas—the property purchased more than a year earlier.[6] Attached to the note was a copy of the August 2012 cashier's check from Livingston. The note required Debtor and her husband to pay $750 monthly until the note was paid in full. A few days prior to the execution of the promissory note, Debtor executed a will stating that in the event of her death, Livingston should be given the deed to the Emporia property.[7]

Several months later, in March 2014, Livingston executed an affidavit claiming an interest in the Emporia property, and he filed it with the Lyon County Register of Deeds on May 1, 2014. The affidavit stated that "by instrument dated August 10, 2012"—the day after the date on the cashier's check he provided for purchase of the Emporia property—Livingston had "an interest" in the Emporia property.[8] The

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preceding the commencement of this case" she had made four monthly payments of $750 each to Livingston on the debt. *Compare* Doc. 1, Schedule J ("Expenses"), Line 1 ("Rent or home mortgage payment"), p. 28, *and* Doc. 1, Form B22A ("Chapter 7 Statement of Current Monthly Income and Means-Test Calculation"), Line 42 ("Future payments on secured claims"), p. 40, *with* Question 3 ("Payments to creditors") on p. 2 of Doc. 21 ("Statement of Financial Affairs–Amended"). The Court notes that Debtor originally disclosed she made no payments to creditors within 90 days of her petition aggregating in excess of $600. Doc. 1, Form B7 ("Statement of Financial Affairs"), Question 3 ("Payments to creditors"), p. 5.

[6] Adversary Compl., Ex. D.

[7] Although the will's terms are not entirely clear, it also provided that if the Emporia property's equity exceeded $200,000, the amount in excess of $200,000 would be payable to two people with the same last name Debtor used before her recent divorce (presumably her children).

[8] Adversary Compl., Ex. G.

Affidavit further states "[t]hat by virtue of said above-mentioned instrument, an unrecorded documents (sic) being held by the undersigned, the undersigned hereby claim (sic) an equitable estate in and to said real property from and after the date of said above-mentioned instrument."[9] Also in May 2014, the county issued a real estate tax statement listing Livingston as a "contract buyer."[10]

Almost a year after Debtor filed her bankruptcy petition, on November 4, 2014, she and her husband executed a warranty deed for the Emporia property to Livingston, for no apparent consideration. Neither Debtor nor Livingston notified the Trustee of the conveyance, notwithstanding that the Trustee had contacted Livingston before the conveyance, on October 16, 2014, to advise him that the Emporia property was now estate property and that he could take no action to enforce his secured claim or any equitable interest without obtaining Bankruptcy Court approval on written notice.[11] Even at a special meeting of creditors held November 17, 2014, a meeting attended by both Livingston and Debtor, neither advised the Trustee of this recent deed although the Emporia property was apparently a subject of that meeting. At the meeting, Debtor admitted signing a promissory note to Livingston soon after her bankruptcy filing and that the Emporia property secured the loan Livingston had made to her.

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[9] *Id.*

[10] *Id.* at Ex. I.

[11] It is unclear when and how the Trustee ultimately became aware of the conveyance. In the Trustee's brief (Doc. 7), she states that "had the Debtor disclosed the existence of the Deed at the time she amended her exemptions, the Trustee would have been on notice of the § 549 transfer by the Debtor."

A week after the special meeting, on November 25, 2014, and almost a year after filing bankruptcy, Debtor finally amended Schedule C in an attempt to exempt her interest in the Emporia property. On the same day, she amended her Schedule D ("Creditors Holding Secured Claims"), describing the "nature of [Livingston's] lien" as a "Mortgage," and tying his mortgage to the Emporia property by listing that address with the same value she had included in her original Schedules.[12] The instructions for Schedule D clearly state the information is to be true "as of the date of filing of the petition."[13]

The Trustee filed her adversary complaint against Livingston on December 29, 2015, alleging that the warranty deed executed by Debtor to Livingston on November 4, 2014 was a postpetition transfer prohibited by § 549, and also that Livingston's purported security interest in the Emporia property was unperfected and therefore subject to avoidance under § 544. The Trustee has requested the Court avoid Livington's security interest in the Emporia property and for other related relief.

Livingston, in his motion to dismiss, argues that the Trustee has not alleged, and cannot demonstrate, an essential element of a § 549 claim based on this reasoning: 1) because Debtor amended Schedule C to exempt her interest in the Emporia property

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[12] Main bankruptcy Case No. 13-41672, Doc. 54, p. 6.

[13] The instructions on Schedule D require debtors to "State the name, mailing address, including zip code, and last four digits of any account number of all entities holding claims secured by property of the debtor as of the date of filing of the petition. . . . List creditors holding all types of secured interests such as judgment liens, garnishments, statutory liens, mortgages, deeds of trust, and other security interests." *Id.*

a year after filing bankruptcy; 2) because the Trustee did not object to that exemption within the 30 days allowed by Rule 4003(b)(1) of the Federal Rules of Bankruptcy Procedure; and 3) because the exemption then relates back to the date of petition, the property was no longer property of the estate when Debtor conveyed it to Livingston in November 2014. Livingston also suggests that the Trustee's § 544 claim must be dismissed—before discovery has even begun—because the Trustee has not yet discovered or attached (as an exhibit to her complaint) a document that constitutes the purported security interest in the real property.

II. Burden of Proof and Standards for Dismissal Under Rule 12(b)(6)

To survive a Rule 12(b)(6) motion to dismiss, a plaintiff's complaint must allege sufficient facts to support a plausible claim for relief.[14] A claim must be supported by factual assertions "'that allow the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.'"[15] When a court considers a motion to dismiss, factual allegations contained in the complaint are accepted as true and the plaintiff has the burden of showing that those facts support a finding in its favor.[16]

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[14] *Bell Atlantic v. Twombly*, 550 U.S. 544, 570 (2007).

[15] *Williams v. Meyer* (*In re Williams*), 438 B.R. 679, 683 (10th Cir. BAP 2010) (quoting *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009)).

[16] *See Cressman v. Thompson*, 719 F.3d 1139, 1144 (10th Cir. 2013) (holding that the court must accept as true all well-pleaded factual allegations in a complaint and it must view those allegations in the light most favorable to plaintiff at the motion to dismiss stage) (citing *Rosenfield v. HSBC Bank, USA*, 681 F.3d 1172, 1178 (10th Cir. 2012)).

III. Analysis

A. Avoidance of a Postpetition Transfer, § 549

To successfully avoid a postpetition transfer, the Trustee must prove that: (1) a transfer of property occurred; (2) the property transferred was property of the estate; (3) the transfer occurred after the commencement of the case; and (4) the transfer was not otherwise authorized by the Bankruptcy Code or the bankruptcy court.[17] If the Trustee fails to allege in her complaint facts supporting any one of these elements, the Court must dismiss the case.[18]

Livingston's motion to dismiss challenges the Trustee's showing on only the second factor, contending that the Emporia property was not property of the estate when Debtor executed the deed to him in November 2014 because of the retroactive effect of Debtor's amended Schedule C. The Trustee counters with several arguments.

First, the Trustee argues that because Debtor had not claimed the Emporia property as exempt *at the time* she voluntarily conveyed it to Livingston, the property was property of the estate for the purposes of the Trustee's rights under § 549. Second, the Trustee argues that even if the property was exempt at the time of the conveyance,

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[17] Section 549 ("[T]he trustee may avoid a transfer of property of the estate . . . that occurs after the commencement of the case and . . . that is not authorized under this title or by the court."); *Sender v. Love Funeral Home* (*In re Potter*), 386 B.R. 306, 308 (Bankr. D. Colo. 2008).

[18] *See Hamilton v. CitiMortgage, Inc.* (*In re Lieurance*), 458 B.R. 757, 762, 765 (Bankr. D. Kan. 2011) (dismissing part of the trustee's complaint for failing to state a claim under § 549 because complaint failed to provide that the actual note and mortgage documents were property of the debtors, and thus property of the bankruptcy estate, at the commencement of the case).

Livingston has no standing to raise Debtor's claim of exemption as a defense against a trustee's avoidance power. Finally, the Trustee argues that § 522(g),[19] which dictates when a debtor may exempt property recovered by a trustee, would bar Debtor from claiming the property as exempt because she voluntarily conveyed it to Livingston.

In response, Livingston generically relies on the right of debtors to freely amend their schedules at any time, and the fact that amendments relate back to the filing of the petition. Second, Livingston denies he lacks standing to raise Debtor's late-filed exemption of the Emporia property as a shield against the Trustee's avoidance powers. Instead, he claims that his argument merely demonstrates that as a matter of law, because of the relation back of the amended Schedule C, the Emporia property is deemed to have been exempt—and thus no longer property of the estate—almost a full year before Debtor conveyed the property to him in November 2014. Finally, Livingston disputes the applicability of § 522(g) because he contends the Trustee has failed to meet the necessary prerequisite for its application—that the trustee "recover" the property *before* the debtor seeks to exempt it, noting the Trustee did not file the avoidance action until after the exemption was allowed.

Livingston primarily relies on *In re OBrien,*[20] a Western District of Michigan bankruptcy case, to support his argument. In *OBrien*, the debtors amended their

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[19] Section 522(g) ("[T]he debtor may exempt . . . property that the trustee recovers under section 510(c)(2), 542, 543, 550, 551, or 553 of this title, to the extent that the debtor could have exempted such property . . . if such property had not been transferred if . . . such transfer was not a voluntary transfer of such property by the debtor and . . . the debtor did not conceal such property . . . .").

[20] 443 B.R. 117 (Bankr. W.D. Mich. 2011).

schedules to exempt a tax refund after they had already spent it.[21] The trustee objected to the exemption and filed a motion for turnover of the refund.[22] The trustee's main argument against allowing the exemption of the refund was that because the refund had already been spent, it could not, as a matter of law, be exempted as the property was "already gone."[23] The court allowed the exemption and overruled the trustee's motion for turnover, finding that the amended exemption related back to the date of filing, at which point the money eventually spent by the debtors was "removed or reclaimed" from the estate.[24]

But *OBrien* provides no real support for Livingston's position under our facts. First, the *OBrien* case was not a trustee avoidance action. Instead, it was a turnover motion directly against the debtor. By contrast, the Trustee here is seeking to avoid what the complaint avers is an unauthorized transfer that occurred at a time when apparently no one disputes Debtor's interest in the Emporia property was property of the bankruptcy estate.

Ironically, the instant case is much more similar to another case decided by the same judge who decided *O'Brien*. In *Lasich v. Wickstrom* (*In the Matter of Wickstrom*),[25] the trustee sought to avoid three prepetition preferential or fraudulent transfers by the

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[21] *Id.* at 124.

[22] *Id.* at 123.

[23] *Id.* at 122.

[24] *Id.* at 135.

[25] 113 B.R. 339 (Bankr. W.D. Mich. 1990).

debtors to one of their creditors. The transferees sought summary judgment, arguing that the property transferred was ultimately exempted by the debtors, and thus the trustee could not avoid the transactions. The *Wickstrom* court labeled this defense—which boils down to an argument that the debtors' other creditors would not have benefitted from the property anyway since the property was exempt and not available for execution by unsecured creditors—the "no harm, no foul" argument. Other courts refer to it as the "diminution of the estate" doctrine.[26]

As the *Wickstrom* court notes, this doctrine was used primarily under the Bankruptcy Act of 1898 to determine whether a preference could be avoided. The doctrine focused on the "issue of whether a given transfer diminished or depleted the debtor's estate" and dictated that "if the transfer (of exempt property) did not diminish or deplete the debtor's estate, the trustee would not be able to avoid the transfer."[27] Thus, under this doctrine, any exempt or exemptible property, whether transferred pre- or postpetition, was not subject to the trustee's avoidance powers. This result was based primarily on the fact that, under the Bankruptcy Act, exempt property was *never* part of the bankruptcy estate.[28]

This doctrine has been rejected by a majority of courts, including by the Tenth

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[26] *Id.* at 346.

[27] *Covey v. United Fed. Sav. & Loan Ass'n of Ill.* (*In re Owen*), 104 B.R. 929, 931 (C.D. Ill. 1989).

[28] *See* Bankruptcy Act of 1898 § 70 ("All property, wherever located, *except insofar as it is property which is held to be exempt* . . . vest[s] in the trustee . . . as of the date of the bankruptcy.") (emphasis added).

Circuit BAP[29] and even more recently by Judge Somers in a § 548 fraudulent transfer case,[30] primarily due to the 1978 change in the Bankruptcy Code defining what constitutes the estate at the time of filing.[31] In *In re Taylor*, the debtors filed bankruptcy several months after granting a security interest in their car to a bank creditor.[32] The bank failed to perfect its security interest prior to the petition date, and the trustee was allowed to avoid the bank's interest under § 544(a)(1) for the benefit of all unsecured creditors notwithstanding that debtors had properly exempted the car in their original schedules. The court held that exemptions are a personal right of the debtor, and that a creditor may not assert that right as a defense in an avoidance

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[29] *See Morris v. First Nat'l Bank & Trust* (*In re Taylor*), No. 97-064, 1998 WL 123027, at *2, n.2 (10th Cir. BAP 1998) (holding that "the law has changed under the Bankruptcy Code in that exempt property is no longer excluded from the bankruptcy estate as it was under the Bankruptcy Act" and thus prior precedent adhering to the diminution of the estate doctrine "no longer has any effect.").

[30] *See Rajala v. Nat'l Ass'n of Postal Supervisors Branch 458* (*In re Krouse*), 513 B.R. 598, 604 (Bankr. D. Kan. 2014) (declining to follow the "no harm, no foul" doctrine and finding that life insurance proceeds paid to a creditor in violation of § 548(a)(1)(B) were property of the estate, regardless of their exempt status).

[31] *See In re Taylor*, 1998 WL 123027, at *2, n.2; *see also Fox v. Smoker* (*In re Noblit*), 72 F.3d 757, 758 (9th Cir. 1995) ("Although the Smokers' theory—known in the caselaw as the 'diminution of the estate' doctrine—has been adopted in the past, the majority of recent cases has rejected it in favor of the principle that an exemption 'is personal to the debtor.'"); *In re Owen*, 104 B.R. at 931 ("This Court believes that the Bankruptcy Court erred in applying the 'diminution of the estate' doctrine."); *Warsco v. Ryan* (*In re Richards*), 92 B.R. 369, 371 (Bankr. N.D. Ind. 1988) ("To the extent this principle [diminution of the estate] was correctly decided, we do not believe it has survived the enactment of the current Bankruptcy Code."). Pursuant to § 541, the bankruptcy estate under the Bankruptcy Code of 1978 now includes "all legal or equitable interests of the debtor in property as of the commencement of the case."

[32] 1998 WL 123027, at *1.

action—regardless whether the exemption was allowed by the court.[33]

The Tenth Circuit BAP in *Taylor* also cited favorably to a Ninth Circuit case, *In re Noblit*,[34] which, in turn, adopted the rationale of a case from the Northern District of Indiana, *In re Richards*.[35] The *Richards* court illustrated the importance of the debtor's personal right to exemptions:

> The right and the opportunity to claim property as exempt is personal to the debtor. It is a right which exists only for the benefit of the debtor and his dependents and it may not be asserted by others, on behalf of the debtor. To permit a creditor to *raise the issue of exemptability* [sic], as a defense to a preference, would violate both the nature and theory of exemptions. The opportunity to claim an exemption would no longer be personal to the debtor, neither would it exist only for his benefit. Instead, the right would be shared by the debtor with certain preferred creditors. Furthermore, the purpose of an exemption is to *keep property out of the hands of a creditor*. Where a debtor makes a conscious choice to voluntarily transfer exemptible property to a creditor, the debtor has, at least impliedly, also made the choice not to claim that property as exempt. The exemption is thus waived.[36]

Accordingly, Livingston does not have standing to raise Debtor's exemption as a defense to this action, and as a matter of policy, to give credence to Livingston's defense (that Debtor's exemption of the property allows her to prefer him—an allegedly unsecured creditor—over her other unsecured creditors) would result in an inequitable

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[33] *Id*. at *2.

[34] 72 F.3d 757.

[35] 92 B.R. 369.

[36] *Id.* at 372 (internal citations omitted) (emphasis added). The *Richards* court also noted that it makes no difference whether it is the creditor who is attempting to use the exemptibility of the property as a defense to an avoidance proceeding as opposed to the debtor doing so. Either way, the result is to rob the debtor (or the estate) of property that otherwise could not have gone to these preferred creditor(s). *Id.* at 371-72.

distribution of property, including a preferential payment to one creditor at the expense of other creditors. This would subvert the spirit as well as the mandate of the Bankruptcy Code and undermine federal policy by allowing some creditors to avoid the priority scheme.[37]

This analysis applies equally to the Trustee's avoidance power under § 549. While debtors may, at any time, freely (in good faith) exempt property in which they retain an interest under § 522,[38] a creditor is not entitled to appropriate this right to defend against an otherwise avoidable transfer. This case proves the point. If the Court prohibited the Trustee from seeking to avoid the transfer here because the Debtor has now elected to exempt it, Livingston could enjoy a windfall to the detriment of other unsecured creditors and administrative claimants.

Thus, the Court finds that the Trustee has, at the pleading stage, satisfied the

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[37] *See Reed v. McIntyre*, 98 U.S. 507, 512 (1878) ("We have often declared that the *pro rata* distribution of the property of the bankrupt was the main purpose of the bankrupt statute. A serious defect in the statute would be developed if its provisions received such a construction as would enable the appellant to defeat that purpose by obtaining an advantage over other creditors.").

[38] The Court need not at this juncture decide the ultimate exemptibility of the Emporia property, but will make two points. First, two fairly recent Tenth Circuit decisions make it clear that a debtor is not entitled to claim an exemption in property he voluntarily transferred, which the trustee then recovered in an adversary proceeding, notwithstanding the trustee's failure to object within the thirty day period of Fed. R. Bankr. P. 4003(b). *Zubrod v. Duncan* (*In re Duncan*), 329 F.3d 1195, 1203-04 (10th Cir. 2003); *Russell v. Kuhnel* (*In re Kuhnel*), 495 F.3d 1177, 1182 (10th Cir. 2007). Alternatively, while the Trustee did not object within the thirty days allowed by Fed. R. Bankr. P. 4003(b)(1) to Debtor's belated attempt to exempt a house in which the Trustee alleges Debtor had no interest to exempt (because by then, she had already conveyed her interest to Livingston), this would not preclude the Trustee, if appropriate facts existed, from objecting under subsection (b)(2) of that rule. That subsection allows a trustee to file an objection to a claim of exemption "at any time prior to one year after the closing of the case if the debtor fraudulently asserted the claim of exemption."

second element she must show to avoid the transfer under § 549. As Livingston does not challenge that the complaint supports each of the other requirements for a claim under § 549, the Court finds that the Trustee has stated a claim, and Livingston's motion to dismiss this claim pursuant to Rule 12(b)(6) must be denied.[39]

B. Avoidance of an Unperfected Security Interest, § 544

To prevail on an avoidance action under § 544, the Trustee must show that the creditor has a valid lien on the subject property and that the lien was not properly perfected under applicable state law when the bankruptcy was filed.[40] Here, the Trustee's complaint alleges that, in August 2012, when Debtor purchased the Emporia property with her non-filing spouse, Debtor obtained a loan from Livingston to enable her to purchase the property.

The Trustee's complaint then supports her § 544 claim with an abundance of factual allegations and supporting exhibits, including:

- the cashier's check remitted by Livingston used to purchase the Emporia property in 2012;
- the insurance policy amended contemporaneously with Debtor's purchase of the Emporia property in 2012 listing Livingston as "mortgagee;"
- Livingston's March 2014 affidavit claiming that "by virtue of said

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[39] Both parties address in their pleadings whether the conveyance is void or voidable by the Trustee. As these arguments address the remedy of a § 549 action, and not whether the Trustee has properly stated a § 549 claim in the first instance, the Court declines to address this argument here.

[40] *See Morris v. St. John Nat'l Bank* (*In re Haberman*), 516 F.3d 1207, 1210 (10th Cir. 2008) ("In Section 544(a)(1), Congress afforded trustees the power to avoid any transfer or obligation that a hypothetical creditor with an unsatisfied judicial lien on the debtor's property could avoid under relevant state nonbankruptcy law."); K.S.A. § 84-9-317(a)(2)(A) (2013 Supp.) ("A security interest . . . is subordinate to the rights of . . . a person that becomes a lien creditor before . . . the security interest . . . is perfected . . . .").

above-mentioned instrument, an unrecorded documents (sic) being held by the undersigned, the undersigned hereby claim (sic) an equitable estate in and to said real property from and after the date of said above-mentioned instrument;"

- Livingston's recording of the affidavit in the county real estate records;
- the real estate tax assessment from Lyon County listing Livingston as a "contract buyer;"
- the promissory note Debtor and her husband executed only a few weeks postpetition to Livingston "for the property purchased at . . . Emporia" for allegedly no additional consideration; and
- Debtor's testimony at the special meeting of creditors admitting her obligation to Livingston was secured by the Emporia property.[41]

Additionally, the Trustee alleges that Livingston's interest was unperfected as of the petition date, as evidenced by the failure of Livingston or the Debtor to follow procedures required by Kansas law to perfect an interest in real property. The Court also notes Debtor's Amended Schedules A and D, filed within a week after the special meeting of creditors, acknowledged under penalty of perjury that Livingston was a secured creditor as of the date of petition and that the collateral securing his claim was the Emporia property.[42]

As a preliminary matter, the Court notes that Livingston's reply brief is completely silent regarding the Trustee's § 544 count, apparently conceding the arguments contained in the Trustee's response to his motion to dismiss on this count. The Court will nevertheless review why the argument contained in his original motion

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[41] Adversary Compl., Exs. C, D, E, G, and I.

[42] Main bankruptcy Case No. 13-41672, Doc. 48, is Amended Schedule A filed November 25, 2014. In the instructions, it directs debtors "If an entity claims to have a lien or hold a secured interest in any property, state the amount of the secured claim." Debtor amended this Schedule to show $200,000 (instead of $0.00 in her original Schedule A) in the column entitled "Amount of Secured Claim." Similarly, in Amended Schedule D, Doc. 45, she admitted that Livingston was a secured creditor with a mortgage on the Emporia property in the amount of $200,000 when she filed her bankruptcy petition.

to dismiss on this count does not justify dismissal.

Livingston argued that because Kansas law requires mortgages to be in writing to be enforceable, and because the Trustee failed to attach to her complaint a copy of the written instrument purporting to be the mortgage, that her complaint fails to state a claim. In so arguing, Livingston misunderstands both Kansas law regarding lien interests as well as the standard for granting a motion to dismiss an avoidance action under § 544 at this stage of the proceedings.

First as to Kansas law. One of the very cases upon which Livingston relies, *EllaMae Investments, LLC v. Terra Firma Development, LLC*,[43] notes that there may not even need to be a document entitled "mortgage" for Livingston to have an enforceable lien (that a trustee could avoid) on the Emporia property:

> 'The form of an agreement by which security is given for a debt is unimportant. If the purpose and intention behind a transaction is to secure a debt, equity will consider the substance of the transaction and give effect to that purpose and intention. A court sitting in equity is not governed by the strict rules of law in determining whether a mortgage has been created. The lien follows if the evidence discloses an intent to charge real property as a security for an obligation."[44]

The Court thus finds that at this stage of the pleadings, the failure of the Trustee to produce a mortgage is simply immaterial in light of all the factual allegations of her complaint—which must be taken as true upon evaluating a motion to dismiss—that

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[43] No. 107,027, 2012 WL 4937470, at *8 (Kan. Ct. App. Oct. 12, 2012).

[44] *Id.* (quoting *Fuqua v. Hanson*, 222 Kan. 653, 655, 567 P.2d 862, 866 (1977)).

the parties intended to create a lien.[45]

Accordingly, the Court finds that the allegations of the complaint meet the standard of Rule 12(b)(6) for stating a claim under § 544(a), and the Trustee is entitled to conduct discovery in an attempt to now prove these allegations.

III. Conclusion

The Court finds that because the Trustee has met her burden to state a claim under Rule 12(b)(6) for both her § 549 and § 544 claims, Livingston's motion to dismiss[46] is denied. The Trustee's complaint demonstrates that there is plenty of smoke; the Trustee will be given the opportunity to prove it is truly a fire.

It is so ordered.[47]

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[45] Even if Livingston's contention was legally accurate (that failure to produce a document entitled "mortgage" means the Trustee cannot ultimately prevail on the merits), the Court would still decline to dismiss this case on that basis at the complaint stage. Judge Nugent recently faced a similar argument raised by a creditor's Rule 12(b)(6) motion to dismiss a Chapter 7 trustee's § 544(a) action. *See In re Gracy*, No. 13-11917, 2014 WL 5500028, at *3 (Bankr. D. Kan. Oct. 30, 2014). Judge Nugent denied the motion, holding that "[w]hile it might have been preferable to attach the mortgages upon which the trustee's claim is founded to the adversary complaint, he (the trustee) has nonetheless sufficiently pled a claim to avoid and preserve the purported lien." *Id.*

[46] Adversary Case No. 15-7046, Doc. 6.

[47] On March 25, 2016, in contemplation of the issuance of this decision, the Court issued an order requiring Livingston to file an answer, if he elects to defend against the complaint, no later than **April 8, 2016**. *See* Order For And Notice Of Scheduling Conference And Requiring Defendant Livingston To File Answer By April 8, 2016. Adversary Case No. 15-7046, Doc. 10.