United States Bankruptcy Court
Western District of Wisconsin

Cite as: [Unpublished]

Daniel Greene, Plaintiff v. Michael E. Kepler, Trustee, Thomas Skok, et al., Defendants
(In re David C. Larson and Valerie A. Larson, Debtors)
Bankruptcy Case No. 96-32800-7, Adv. Case No. 96-32800-7-A

United States Bankruptcy Court
W.D. Wisconsin, Madison Division

January 30, 1997

Jeffrey W. Jensen, Milwaukee, WI, for the plaintiff.
Michael E. Kepler, Kepler & Peyton, Madison, WI, for the defendant, Michael E. Kepler.
Michael B. Van Sicklen, Foley & Lardner, Madison, WI, for the defendants, Benjamin Investments, et al.

Robert D. Martin, United States Bankruptcy Judge

MEMORANDUM DECISION

On June 15, 1996, Daniel Greene, d/b/a Tom Gorak Motors, brought his 1995 Chevrolet Corvette to Capitol Corvette and agreed in writing to sell it to David Larson for $33,400. On July 1, the parties amended the agreement because the sale price was actually $33,900, and on July 2, Mr. Larson paid by check. Mr. Greene assigned his interest to Mr. Larson on the certificate of title. He delivered a photocopy of the title to Mr. Larson but kept the original. An involuntary bankruptcy was filed against Mr. Larson on July 11. The bankruptcy trustee took custody of the car and refuses to release it.

Mr. Greene alleges that the bankruptcy estate has no equitable interest in the Corvette. He claims Mr. Larson procured the car by fraud because the Capitol Corvette bank account had insufficient funds on July 3 to cover the check he received from Mr. Larson. Consequently, Mr.

Greene says no sale actually took place, and the Corvette should be deemed to have been held in constructive trust, not as part of the bankruptcy estate. The trustee claims the car is an asset of the bankruptcy estate under §541 and disputes Mr. Greene's fraud allegation. But even if there was fraud, the trustee argues that the Corvette is still property of the bankruptcy estate because no constructive trust was imposed prior to the bankruptcy.

Benjamin Investments, Benjamin Plumbing, Inc. and their owners, Dale Benjamin and Terry Benjamin, hold a valid lien on all of the debtor's inventory, contract rights and other assets. The Benjamins join the trustee in asking the court to dismiss Mr. Greene's complaint and declare the Benjamin security interest in the Corvette superior to any interest Mr. Greene might have.

At trial on December 9, 1996, the parties stipulated to facts (which are herein adopted as findings) and put on no further evidence. I took the matter under advisement and asked for supplemental briefing on the legal significance of Mr. Greene retaining the original title certificate.

Article 2 of the Uniform Commercial Code applies to "transactions in goods," and is generally applicable to transactions involving transfer of automobile ownership. Knutson v. Mueller, 68 Wis.2d 199 (1975) expands on the role of the U.C.C.:

> [S]ection 342.15(3), rather than the Uniform Commercial Code governs time of transfer of car ownership for purposes of determining liability of the owner in a personal injury action, even though the Uniform Commercial Code governs "as between the parties" with respect to their rights and liabilities arising under the law of sales.

Id. at 207. Wis. Stat. §342.15 provides that to transfer ownership of a car, an owner must execute an assignment and warranty of title on the title certificate and mail or deliver it to the transferee. If an owner complies with §342 and also delivers the vehicle to the transferee, the owner is not liable for any

damages thereafter resulting from operation of the vehicle. But §342.15 does not establish when title has been transferred as between the parties, Wis. Stats. §402.401(2) does.

Between Mr. Greene and Mr. Larson, the title could pass in any manner and on any conditions explicitly agreed on by the parties.[1] They did not have an explicit agreement. Presumably, Mr. Greene held on to the original title certificate intending to reserve title until the check cleared. He argues that title did not pass because the check did not clear. The trustee claims Mr. Greene transferred title when he delivered the car and accepted the check. Because the parties do not have an explicit agreement:

> [T]itle passes to the buyer at the time and place at which the seller completes the seller's performance with reference to the physical delivery of the goods, despite any reservation of a security interest and even though a document of title is to be delivered at a different time or place ....

Wis. Stat. §402.401(2). In short, title transferred no later than when Mr. Greene left the car with Mr. Larson at Capitol Corvette on July 2.

However, Mr. Greene transferred voidable title because Capitol Corvette paid with a bad check. Title is "voidable" when the underlying contract between a seller and defrauder is subject to avoidance at common law. Met-Al, Inc. v. Hansen Storage Co., 828 F.Supp. 1369 (E.D. Wis. 1993). Wis. Stat. §402.403[2] codified the common law rule that title is "voidable" if a seller delivers goods in

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[1]Wis. Stat. §402.401 provides 'in relevant part:

(1)... Subject to these provisions and to ch. 409, title to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties.

[2]Wis. Stat. §402.403(l) provides:

A purchaser of goods acquires all title which the purchaser's transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase the purchaser has such power even though:

exchange for a check that is later dishonored. The seller then has the right to rescind the sale agreement and reclaim the goods. Voidable title, however, is not void. Under §402.403, a seller loses her right to rescind and reclaim if the goods are sold to a "good faith purchaser for value."

The Wisconsin Supreme Court in Hudiburg Chevrolet, Inc. v. Ponce, 17 Wis.2d 281 (1964), applied §402.403 and allowed a "good faith purchaser" to keep a car over the objection of a defrauded seller. In Hudiburg, a chevy dealer sold a car to a Mr. James. The sales agreement required $500 down and payment of the rest over 36 months. The agreement reserved title in the dealer until payment in full, and the dealer held the original certificate of title. Mr. James paid by check and the check bounced. In the meantime, Mr. James obtained a new certificate out of state and sold the car to a third party. When the bank returned Mr. James' check "NSF," the dealer sued to recover the car. The court held that Mr. James had the "property interest of a conditional sale contract vendee" and could transfer *good* title to a good faith purchaser for value. That transfer rendered the dealer's recission ineffective. Without repossessing the car, or in some way making it impossible for a purchaser to buy in good faith, the seller had not voided the title. Under Hudiburg, a seller may rescind a sales agreement if the check is dishonored -- but only if the seller actually reclaims the goods. If the goods have passed to a good faith purchaser, the defrauded seller is out-of-luck.

The reference in Hudiburg to the rights of a "conditional sales contract vendee" is an anachronism. The common law "conditional sale" has been supplanted by the Article 9 purchase money security interest. Gilmore, Security Interests in Personal Property, vol. I, §3.2 (1965).

(a) The transferor was deceived as to the identity of the purchaser; or
(b) The delivery was in exchange for a check which is later dishonored; or
(c) It was agreed that the transaction was to be a "cash sale"; or
(d) The delivery was procured through fraud punishable as larcenous under the criminal law.

Article 9 of the U.C.C. now governs a "conditional sale." Id. at §3.3. However, Article 2 of the U.C.C. preserves a remedy for a seller who intended to retain title until the check cleared but did not comply with Article 9. See infra Wis. Stat. §402.702. As under the common law discussion in Hudiburg, that remedy is subject to the rights of a "good faith purchaser for value." Wis. Stat. §402.403(l).

In the present case, Mr. Greene intended to retain title until payment, but he did not comply with Article 9. Having paid with a bad check, Mr. Larson held only voidable title to the Corvette. By the time the check bounced, Mr. Greene could not repossess the car because the automatic stay was in effect. What remains to be determined is whether at the time the bankruptcy was filed Mr. Greene still had a right to reclaim the Corvette.

The right to reclaim is described in Wis. Stat. §402.702 which provides in pertinent part:

> (2) Where the seller discovers the buyer has received goods on credit while insolvent the seller may reclaim the goods upon demand made within 10 days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within 3 months before delivery the 10-day limitation does not apply....
> (3) The seller's right to reclaim under sub. (2) is subject to the rights of a buyer in ordinary course or other good faith purchaser under s. 402.403....

The right to reclaim can be cut off by a good faith purchaser or by the running of time. In the present case, it is unnecessary to determine if the 10-day limitation applies because the Benjamins are "good faith purchasers."

Voidable title can be encumbered with a security interest. In Return of Property in State v. Pippin, 176 Wis.2d 418 (Ct.App. 1993), Mr. Pippin purchased jewelry from Osterman Jewelers under an agreement which gave Osterman a security interest and prohibited Pippin from selling or encumbering the collateral. Without consent, Pippin used the jewelry to secure $8,000 in loans from

pawnbrokers. When Pippin's down payment check bounced, Osterman called the police. They seized and returned the jewelry to Osterman. Only then did Osterman perfect its security interest in the jewelry. The pawnbrokers sued claiming their perfected security interests superior to Osterman's. On appeal, the court found Pippin held voidable title to the jewelry he procured by the dishonored check. The court reasoned that if he could transfer title to a good faith purchaser for value he could also transfer a security interest to a creditor. "Pippin's rights in the collateral were sufficient to allow attachment of a security interest." Id. at 430. Because Osterman did not timely perfect, the pawnbrokers had priority.

Furthermore, in House of Stainless v, Marshall & Ilsley Bank, 75 Wis.2d 264 (1976), the Wisconsin Supreme Court said a prior blanket security interest or floating lien such as that held by the Benjamins attaches to voidable title. M&I Bank held a perfected blanket security interest in all of Alkar's inventory, then owned or after acquired, when Stainless Steel, Inc. sold goods worth $36,000 to Alkar on open account. Within 10 days, Stainless learned Alkar was insolvent, promptly gave notice to M&I Bank and requested return of the goods. M&I quickly sold the goods to a third party. Stainless then sued M&I for conversion. The Wisconsin Supreme Court reversed the lower courts and found M&I became a "good faith purchaser for value" under §402.403(1) when M&I's security interest attached to the voidable title. The court found Stainless had properly demanded return of its goods under §402.702(2), but because M&I's security interest attached before Stainless could repossess, Stainless lost its right of reclamation. Section 402.702(3) incorporates §402.403(l). The seller's remedy on discovery of insolvency is subject to the "good faith purchaser" exception. Stainless, supra at 270. The good faith of M&I was not questioned, since the U.C.C. describes good faith as "honest in fact." §401.201(19). Furthermore, a "purchaser" is one who takes by purchase, and a "purchase" includes

"taking by sale, discount, . . . lien, . . . or any other voluntary transaction creating an interest in property." §401.201(33), (32). Finally, M&I's pre-existing claim constitutes "value" under §401.201(44)(b) ("security for or in total or partial satisfaction of a preexisting claim.").

> One commentator endorsed the Stainless result:
> [E]quities may seem to favor the seller over the secured party who did not give new value in latching on to the after-acquired property. The secured party with the after-acquired property clause may seem to get a windfall at the expense of the sellers, who provided the property. But it is hard to quarrel with the . . . application of statutory provisions .... The case illustrates the "voidable title" area. Title passes to buyer, but seller has a right to rescind the title, until a bona fide purchaser for value intervenes -- that is the general restitutionary rule. Section 2-702 [which incorporates 2-403(l)] merely tinkers with it.

Id. at 273 n.23 quoting Skilton, Security Interest in After-Acquired Property Under the Uniform Commercial Code, 1974 Wis. L. R. 925, 946. See also In Re Shattuc Cable Corp., 138 B.R. 557 (Bankr. N.D. Ill. 1992) ("It appears to be a well-settled rule of law that the holder of a perfected security interest under an after-acquired property clause will be treated as a good faith purchaser under §2-403 with rights superior to the seller's right of reclamation . . . . "); In re Samuels & Co., 526 F.2d 1238 (5th Cir. 1976) (same); In re Pester Refining Co. 964 F.2d 842 (8th Cir. 1992) (same); But see In the Matter of Reliable Drug Stores, Inc., 70 F.3d 948 (7th Cir. 1995) (declining to decide the issue). In short, although a blanket lien-holder is not an obvious "good faith purchaser," by definition the blanket lien-holder is a purchaser under the statute. In the present case, Mr. Greene's right to reclaim is subject to the Benjamins' blanket lien.

Although primed in this case by the Benjamins' security interest, the trustee's powers under §544 may extinguish a seller's right to reclaim goods as well. The court in In Re Tom Woods Used Cars, Inc., 24 B.R. 529 (Bankr. E.D. Tenn. 1982) prohibited a seller from reclaiming in bankruptcy despite the absence of a "good faith purchaser." That court held that the trustee's strong-arm powers

primed the dealer's right of reclamation, reasoning that Article 2 allows parties to agree when title will pass, but the seller can not retain title after delivery without perfecting under Article 9:

> Once an automobile is delivered to the buyer, nondelivery of the title certificate does not prevent title from passing to the buyer, does not give the seller any rights greater than a security interest, and in fact does not even give the seller a security interest unless there is a written agreement [pursuant to 9-203].

Non-delivery of the title certificate did not prevent a sale from occurring. The dealer's intention to retain title was nothing more than that: an intention to retain title after the delivery of sold goods. The trustee then, as a judgment creditor under §544, was without knowledge of any claims on the car by third parties and could both avoid any unperfected retention of title and extinguish any defrauded seller's right to reclaim.

Notwithstanding the Benjamins' blanket lien and the trustee's powers in the bankruptcy, Mr. Greene lost his reclamation right for another reason: Mr. Greene did not comply with §546(c). The Bankruptcy Code preserves a seller's right of reclamation in §546(c) if a seller sold to the debtor in the ordinary course of business while the debtor was insolvent and the seller had a statutory or common law right to reclaim under applicable nonbankruptcy law. Ginsberg & Martin, Ginsberg & Martin on Bankruptgy, §9.05[A] (4th ed. 1996). But, the Code also requires that the seller demand reclamation in writing within 10 days after the debtor received the goods. Id. §546(c) provides in relevant part:

> [T]he rights and powers of a trustee ... are subject to any statutory or common-law right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, but --
>
> (1) such seller may not reclaim any such goods unless *such seller demands in writing reclamation* ...
>
> (A) before ten days after receipt of such goods by the debtor[.]

11 U.S.C. §546(c) (emphasis added). Assuming Mr. Greene could establish the debtor was insolvent

and sold the Corvette in the ordinary course of business,[3] Mr. Greene still did not comply with the 10-day demand requirement of §546(c). Thus, he lost any reclamation right otherwise preserved in bankruptcy. "If the §546(c) time period lapses without a demand, the right of reclamation is lost." Ginsberg & Martin, supra at §9.05[A]; See In Re Rea Keech Buick, Inc., 139 B.R. 625 (Bankr. D.Md. 1992).

As an alternative to contending he retained title, Mr. Greene alleges that Mr. Larson obtained the car through fraud and that the car is not property of the bankruptcy estate. The Seventh Circuit has held that fraudulently obtained property is *not* part of the estate, and the trustee has no power over it. In re Teltronics, Ltd., 649 F.2d 1236, 1238 (7th Cir. 1981). Teltronics was convicted of mail fraud and found civilly liable under the Illinois Consumer Fraud Act, which provided a distribution to defrauded customers through a receiver. Teltronics' assets were frozen and put in the receiver's custody. A few days later an involuntary bankruptcy was filed and the bankruptcy trustee requested turnover of Teltronics' assets from the receiver. The
Seventh Circuit held that turnover was inappropriate because the fraudulently-obtained assets were not part of the bankruptcy estate. The court noted that although fraud victims usually are limited to claims against the estate, in Teltronics that was inappropriate because the state Attorney General had already intervened on the consumers' behalf prior to the bankruptcy.

Teltronics is distinguishable from the present case because Mr. Larson has not been convicted

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[3]Ginsberg & Martin cite to the "ordinary course of business" defense under §547(c)(2). The buyer and seller must have sold in the ordinary course between them and in the ordinary course in their particular business or industry.

of fraud, nor has fraud been previously established in state court. Moreover, neither the state nor federal government has intervened pre-petition to equitably distribute any fraudulently obtained property. In fact, it is not certain that the U.S. Attorney will prosecute in this case. Despite the "ordinariness" of this case in comparison to Teltronics, Mr. Greene could argue that he did not have time, pre-petition, to get a state court determination on the fraud issue. The bankruptcy was filed shortly after he learned Mr. Larson did not have funds to honor the check.

One bankruptcy court did not require a prior fraud judgment and imposed its own constructive trust when fraud was proved to have been committed after the bankruptcy petition was filed. In re Baxco., 148 B.R. 855 (Bankr. N.D. M. E.D. 1992) (Katz, J.). But Mr. Larson's alleged fraud occurred pre-petition. Baxco does not address Mr. Greene's argument that a bankruptcy court should adjudicate his pre-petition fraud claim before the bankruptcy estate is fixed.

Section 541 says that property of the estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case." However, subsection (d) says that the estate *does not* contain property in which the debtor holds bare legal title:

> Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest ... becomes property of the estate under subsection (a)(1) or (2) ... 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.

"Section 541(d) describes the classic "trust' situation: a trustee holds bare legal title to property for the benefit of... one or more beneficiaries who hold the equitable title or interest in the trust property." In re Foos, 183 B.R. 149, 155 (N.D. Ill. E.D. 1995). If the debtor holds only bare legal title without an equitable interest, the bankruptcy estate's interest is likewise limited. The present case is not a "classic trust situation." Here, any trust imposed would be a "fictional" constructive trust. Collier states that

"generally, money paid to a debtor prior to bankruptcy by wrongdoing is impressed with a constructive trust that follows it into the hands of the estate." Id. But, courts often limit §541(d) to constructive trusts created by pre-bankruptcy judgments. See Re Omegas Group, Inc., 16 F.3d 1443, 1449 (6th Cir. 1994); In re Dow Corning Corp., 192 B.R. 428 (Bankr. E.D. Mch. N.D. 1996); In re Foos, supra. Under these cases, Mr. Greene's allegation of fraud would not exempt his car from the bankruptcy estate under §541.

While this court may not be precluded from hearing the fraud issue and imposing a constructive trust, there is no basis on which to do so. Unfortunately for Mr. Greene, an involuntary was filed before he could pursue a state law remedy. Thus, he can not benefit from the preclusive effect of a prior court ruling. He would have to establish in this court each of the elements of fraud. But even his pleadings fail to set out those elements.[4] In his most specific statement he cites State v. Meado, 163 Wis.2d 789 (Ct. App. 1991), and alleges "Mr. Larson committed the crime of theft by fraud." (Plaintiffs Memorandum of Law at p.2). However, under Wisconsin's theft statute, Wis. Stat. §943.20(l)(d), Mr. Greene has not plead nor proved the required elements.[5] Under Wisconsin's bad check statute, Wis Stat. §943.24, Mr. Greene could have taken advantage of a statutory presumption

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[4]FRBP 7009 which incorporates Rule 9(b) FR Civ P requires specific pleading of allegations of fraud:

> (b) Fraud, Mistake, Condition of the Mind. In all averments of fraud ... the circumstances constituting fraud ... shall be stated with particularity....

[5]Wis. Stat. §943.20(l)(d) provides:

> Whoever does any of the following may be penalized ...
>
> (d) Obtains title to property of another person by intentionally deceiving the person with a false representation which is known to be false, made with intent to defraud, and which does defraud the person to whom it is made. "False representation" includes a promise made with intent not to perform it if it is a part of a false and fraudulent scheme.

of intent[6] had he proved the other elements. But Mr. Greene has not plead or proved the elements of either statutory or common law fraud.[7] The stipulation of facts which constitute the entire factual record of this case does not provide the predicate facts. Nor has Mr. Greene directed the court's attention to any presumption or rule which would make such proof unnecessary. The mere passing of an NSF check is not independently sufficient to find fraud nor to provide the basis for the imposition of a constructive trust as a remedy.

On findings and conclusions contained herein, the complaint of the plaintiff must be dismissed. Judgment may be entered accordingly.

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[6]Wis. Stat. §943.24(3) provides in relevant part:

Any of the following is prima facie evidence that the person at the time he or she issued the check intended it should not be paid:

(b) Proof that, at the time of issuance, the person did not have sufficient funds or credit with the drawee and that the person failed within 5 days after receiving notice of nonpayment or dishonor to pay the check ... ; or

(c) Proof that, when presentment was made within a reasonable time, the person did not have sufficient funds or credit with the drawee and the person failed within 5 days after receiving notice of nonpayment or dishonor to pay the check ....

[7](1) a false representation of fact;
(2) made with intent to defraud;
(3)reliance by the injured party on the misrepresentation; and
(4)actual and justifiable reliance
Loula v. Snap-On Tools Corp., 175 Wis.2d 50 (Ct.App. 1993).