IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH

CENTRAL DIVISION

213

In re DENNIS L. CARLSON, INC., a Utah corporation, Debtor.	BANKRUPTCY NO. 86-C-01209
R. KIMBALL MOSIER, trustee Plaintiff, vs. A. PAUL SCHWENKE, BRUCE J. UDALL, AND SCHWENKE & UDALL INVESTMENTS, INC., Defendants.	ADVERSARY PROCEEDING NO. 86-PC-0575 DISTRICT COURT NO. 86-C-0981-J MEMORANDUM OPINION AND ORDER

This case involves a trustee's sale of real property. The bankruptcy court refused to vacate a previous order approving the sale and the defendants have moved this court for a stay.

The facts in this case are complicated and disputed. Those relevant to this appeal involve property referred to by the parties as Meadow Crest, a residential house and lot in Murray, Utah. Meadow Crest was built by the debtor in this case, Dennis Carlson, Inc (Carlson, Inc.), a contracting firm. At the time the petition was filed, the house was new and as yet unoccupied. It had been listed for sale, unsuccessfully, at $170,000.

On March 19, 1986, five days before the Carlson bankruptcy was filed, the defendants in this case, in their capacity as

Schwenke & Udall Investments, Inc., entered into a contract to purchase two properties owned by Carlson, Inc. At the time, the law firm of Schwenke & Udall represented Carlson, Inc. The real estate contract provided for the sale of Meadow Crest and another property for $20,000 cash plus assumption of outstanding debt. $15,000 was paid to Dennis Carlson and the remaining $5000 was set off against outstanding attorney's fees. Mr. Schwenke was to get the Meadow Crest property and Mr. Udall the other. Schwenke & Udall Investmentswas to assume the debts attached to the properties.

The construction mortgage on Meadow Crest was in default and the mortgagee, American Equity, was about to foreclose. Solely to stop this foreclosure, Schwenke & Udall filed a chapter 11 petition on behalf of Carlson, Inc. on March 24, 1986. The fact that a contract for sale of the two properties had been executed was noted on the schedule of assets filed in the bankruptcy. Two to three weeks after filing the petition, Schwenke took possession of Meadow Crest.

In May 1986, on American Equity's motion, R. Kimball Mosier was appointed trustee for the debtor. Within a few weeks after his appointment, after receiving an offer on the Meadow Crest property,[1] the Trustee filed a Notice of Sale and Motion for

[1] Mr. Harris, the prospective purchaser of Meadow Crest, attended the hearing on this appeal. He is also an attorney. Mr. Harris and his wife made their first offer on Meadow Crest while it was listed on the market. That offer was evidently rejected. On learning of the bankruptcy, and after attending the first meeting of creditors, Harris made a second, higher offer to the Trustee.

Approval with respect to that property. A copy of that notice was received by Schwenke. The notice invited higher offers than the $155,000 proposed sale price. On receiving this notice, Schwenke contacted the Trustee and informed him of his claimed purchaser's interest in Meadow Crest. At the request of the Trustee, Schwenke forwarded a copy of the real estate contract for the sale of the two properties to the trustee.

The Trustee responded to Schwenke's purchaser's claim by filing an adversary proceeding against Schwenke, asking, inter alia, for a quiet title declaration. That action has not yet been tried. Schwenke interpreted the commencement of the quiet title action as "superseding" the Motion for Approval of Sale. As a result, Schwenke claims, he did not attend the hearing on approval of the sale. In fact, no one appeared at that hearing except the Trustee and the prospective purchaser of the Meadow Crest property. The court approved the sale of "the property" and Schwenke received a copy of the court order. Schwenke did not appeal that order. Rather, more than a month later, on September 25, 1986, Schwenke filed a motion to vacate the order approving the sale. The basis for this motion was Schwenke's claim that his failure to appear at the hearing, given the intervening adversary proceeding, constituted "excusable neglect" under Fed. R. Civ. P. 60(b). The bankruptcy court denied the motion to vacate the order approving the sale. It is that order of denial from which Schwenke appeals and now seeks to stay pending appeal of the denial order.

The situation as it exists now is this: The Trustee, concerned that the estate is losing its equity in the property, wants Schwenke out and the sale to Harris to go forward. American Equity agrees, pointing to the fact that interest on the debt on the property continues to accumulate at the rate of $43.91 a day. That debt, and two other smaller liens on the property, total $152,500. The prospective purchaser Harris is anxious to move in, frustrated with the inability to close. Schwenke continues in possession of the property, claiming his rights under the contract. He fears a forfeiture of the portion of the $15,000 paid under the contract attributable to Meadow Crest. He also claims that he has made improvements to the property totalling nearly $23,000.

As a preliminary matter, staying the order that Schwenke appeals from would accomplish nothing. That order simply refused to disturb a final order approving the sale to Harris. Schwenke has missed his opportunity to appeal that first order. What he really seeks here is an exercise of the court's broad equitable powers to stay the closing of the sale to Harris and his eviction from the property.

This court is of the opinion that Schwenke's failure to appear at the hearing on the approval of the sale and subsequent failure to bring a timely appeal is not "excusable neglect." If counsel for the alleged purchaser is unfamiliar with bankruptcy

practice, he should either become familiar or associate someone with the necessary skill to represent his client. In this case we are not faced with an innocent client falling victim to his attorney's incompetence. Schwenke, in effect, represents himself.

That would be the end of the matter were it not for what appears to be a basic misunderstanding on the part of all the parties to this appeal. That misunderstanding involves what property it is that the Trustee can sell or has sold.

The Trustee argues that section 363(f)(4) of the bankruptcy code[2] allows him to sell the property "free and clear" of Schwenke's interest if that interest is in "bona fide dispute." 11 U.S.C. § 363(f)(4). He further argues that the quiet title action demonstrates a good faith dispute as to Schwenke's alleged interest. This argument ignores the specific limitations on section 363(f). That subsection is limited to sales authorized under subsections 363 (b) or (c). Id. Those sections, in turn, are specifically limited to "property of the estate." 11 U.S.C. § 363(b) & (c). The question becomes, then, what is the "property of the estate" that section 363 authorizes the Trustee to sell?

---

2 11 U.S.C. § 363(f) reads, in pertinent part:

> The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if--
> . . . (4) such interest is in bona fide dispute.

The answer comes easily in section 541, entitled "property of the estate." 11 U.S.C. § 541. That section defines "property of the estate" for purposes of the bankruptcy code. That definition includes, obviously, property the trustee may sell under section 363. Subsection (d) of section 541 reads, in pertinent part:

> 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 . . . only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

11 U.S.C. § 541(d). Thus, if the debtor held only a legal interest in the Meadow Crest property on March 24, 1986, then it is only that interest which section 363 allows the Trustee to sell.

State property law should be applied in order to characterize the estate's interest in Meadow Crest. In re National Equipment & Mold Corp., 64 Bankr. 239, 245 (Bankr. N.D. Ohio 1986); In re Mortgage Funding, Inc., 48 Bankr. 152 (Bankr. D. Nev. 1985). Utah recognizes the doctrine of equitable conversion. Allred v. Allred, 15 Utah 2d 396, 393 P.2d 791 (1964). Under that doctrine, "an enforceable executory contract of sale has the effect of converting the interest of the vendor of real property to personalty." 393 P.2d at 792. The vendor's interest in the property is merely legal, although he retains an equitable lien on the property for any balance unpaid. 27 Am. Jur. 2d, Equitable Conversion § 11 (1966). If the buyer (in this

case, ostensibly Schwenke) holds the equitable right of ownership, then the vendor as trustee in bankruptcy may hold only a legal interest.

The schedules filed in this bankruptcy clearly reflect the executory contract for sale of the Meadow Crest property. Under the principles of equitable conversion, therefore, the equitable interest in the property did not become "property of the estate" under section 541. Thus, the only property interest in Meadow Crest that the Trustee may sell was personalty: the rights remaining in Dennis Carlson, Inc. under the real estate contract.

It seems to the court that in order to convey clear title to the purchaser, the Trustee will have to pursue either his quiet title action, an avoidance action or some other proceeding to settle the question of whether the contract for sale to Schwenke is enforceable. The contract for sale, on first glance, places the equitable interest in Meadow Crest outside section 541's definition of the property of the estate. Until the Trustee either demonstrates that the contract did not accomplish this or by some action brings the property into the estate, he cannot sell any more than the seller's interest held under the contract subject to the purchaser's interest. That purchaser's interest--whatever it is--in turn may be subject to a power of avoidance.

It may be important to point out what this court is not

saying today. It is not saying that any property of the estate encumbered by outside interests cannot be sold free of those interests. Generally, section 363 empowers such sales. But in this case section 363 is limited by the specific exclusion from "property of the estate" set forth in section 541(d). Nor is this court saying that Schwenke is automatically entitled to the protections of the doctrine of equitable conversion. That doctrine is an equitable remedy and need not be applied in cases where justice does not demand its application. However, Utah has recognized the doctrine as a "general rule," Allred v. Allred, 393 P.2d at 792. Before Schwenke's interest is ignored, therefore, a court should determine that the doctrine is inapplicable. Finally, this court is not expressing any opinion as to whether Schwenke is currently entitled to possession. What this court does maintain is that a sale of "the property" requires an exquisite and precise definition of what "the property" is. Absent that, the purchaser may have purchased a legal interest subject to a purchase contract, which in turn may be subject to a power to avoid. It seems to me that he wants more than that.

Therefore, in the interest of all parties to this proceeding, the closing of the sale by the trustee of anything more than the legal interest in the property is STAYED until such time as Schwenke's interest in the property, if any, is determined.

So ordered.

Dated this 12 day of November, 1986.

BY THE COURT

Bruce S. Jenkins, Chief Judge
United States District Court

ıpies mailed to counsel 11/13/86: mw

Kimball Mosier, Esq.
Paul Schwenke, Esq.
ıerk, U.S. Bankruptcy Court