UNITED STATES BANKRUPTCY COURT

DISTRICT OF HAWAII

In re REYNALDO VERGARA SAGON & JUANITA ROMUSOD SAGON, Debtors.	)	Case No. 02-02950 Chapter 13
FINANCE FACTORS, LIMITED, Plaintiff, vs. REYNALDO VERGARA SAGON, et al., Defendants.	)	Adv. Proc. No. 02-00071

MEMORANDUM DECISION REGARDING FINANCE FACTORS' MOTION FOR SUMMARY JUDGMENT AND THE SAGONS' COUNTER MOTION FOR SUMMARY JUDGMENT

At issue in this adversary proceeding is whether the court should correct a transfer certificate of title ("TCT") to add a mortgage in favor of Finance Factors, Limited ("Finance Factors"), that was omitted from the TCT due to an error by the recording office. I conclude that because the Chapter 13 trustee has

the rights of a bona fide purchaser for value of the subject property, the TCT may not be corrected as Finance Factors requests.

Background

There are no genuine issues of material fact.

On or about September 21, 1994, the debtors executed an adjustable rate mortgage in favor of Finance Factors (the "FF Mortgage") to secure a loan from Finance Factors to the debtors in the principal amount of $204,000 (the "FF Loan"). The FF Mortgage encumbered two parcels of real property owned by the debtors: (1) the debtors' residence located at 95-708 Makaiolani Street, Mililani, Hawaii (the "Mililani property"); and (2) the debtors' investment property located at 87-162 Kulahanai Place, Waianae, Hawaii (the "Waianae property"). The Mililani property is registered in the Land Court of the State of Hawaii. Accordingly, all encumbrances must be noted on the TCT conveying the property. The FF Mortgage was registered with the Land Court on September 30, 1994, as Document No. 2184070, and duly noted as an encumbrance on the TCTs covering the property (TCT Nos. 409,309 and 413,718).

The debtors and their daughter transferred the Mililani property back and forth four separate times. On or about September 10, 1996, the debtors transferred the Mililani property to themselves as the trustees of their revocable

living trusts. On or about June 30, 1998, the debtors, as trustees, transferred the Mililani property to the debtors, individually, and to the debtors' daughter. On or about July 17, 1998, the Mililani property was transferred to the debtors' revocable living trusts and their daughter. On August 2, 2001, the debtors (as trustees) and their daughter transferred the Mililani property to the debtors, as trustees of the revocable living trusts. The transfers were made for estate planning purposes. There was no consideration supporting any of the transfers.

When the fee simple interest in registered land is transferred, the Land Court cancels the existing TCT and issues a new TCT to the new owner. Accordingly, whenever the debtors and their daughter transferred the Mililani property, the Land Court issued a new TCT. The above transfers resulted in the cancellation of TCT Nos. 409,309 and 413,718, and the creation and cancellation of a series of TCTs. TCT No. 558,184 currently covers the Mililani property.

When registered land is transferred and the Land court issues a new TCT, the Land Court is supposed to note all existing encumbrances on the new TCT. The Land Court inadvertently failed, however, to note the FF Mortgage on the new TCTs, including TCT No. 588,184. Carl Watanabe, Registrar of Conveyances for the Land Court of the State of Hawaii, admitted that this failure

to note the FF Mortgage on the new TCTs was an error on the part of the Land Court.

In January of 2002, the debtors sold the Waianae Property and used a portion of the proceeds to pay down the FF Loan. Finance Factors executed and filed a Partial Release of Mortgage as to the Waianae Property only in January of 2002. Finance Factors never released the FF Mortgage as to the Mililani property and never filed such a release with the Land Court. The debtors have not paid the FF Loan and are in default on the FF Loan.

In 2001, the debtors refinanced their obligations on their Mililani property and obtained a loan and mortgage from Irwin Mortgage Corporation ("Irwin"). On June 26, 2002, Finance Factors filed a Land Court petition against the debtors and Irwin that sought a court order to correct the TCTs nunc pro tunc to include the FF mortgage. The debtors filed a Chapter 13 bankruptcy petition on August 13, 2002. On that date, the FF mortgage was not noted as an encumbrance on the TCT conveying the Mililani property.

On October 15, 2002, the debtors removed the Land Court petition to the bankruptcy court. Irwin filed a motion for summary judgment against Finance Factors. The court held that Irwin, which had a mortgage recorded subsequent to that of Finance Factors, was a purchaser in good faith and for value. Thus, the

court could not correct the TCT in a way that would disturb the priority of Irwin's mortgage.

On May 2, 2002, Finance Factors filed a Motion for Summary Judgment against the debtors. On May 13, 2003, the Sagons filed a counter-motion for summary judgment against Finance Factors.

The motions came for hearing on May 30, 2003. Wray Kondo, Esq., appeared on behalf of Finance Factors. Bradley Tamm, Esq., appeared on behalf of the Sagons. Jade Ching, Esq., appeared on behalf of Irwin. At the hearing, the court directed the parties to file additional memoranda on the issue of whether the trustee's status as a bona fide purchaser of real property from the debtor under 11 U.S.C. § 544(a)(3) would prohibit the correction of the TCT on the Mililani property. The court has considered the pleadings, arguments made at the hearing, and additional briefs, and renders the following decision.

Discussion

Summary judgment is appropriate when there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c). The moving party has the initial burden of "identifying the portions of the materials on file that it believes show an absence of a genuine issue of material fact." T.W. Elec. Serv., Inc. v. Pacific Elec. Contractors Ass'n,

809 F.2d 626, 630 (9th Cir. 1987) (citing Celotex Corp. v. Catrett, 477 U.S. 317 (1986)). If the moving party meets its burden, then the opposing party may not defeat a motion for summary judgment in the absence of any significant probative evidence tending to support its legal theory. Commodity Futures Trading Comm'n v. Savage, 611 F.2d 270, 282 (9th Cir. 1979). In a motion for summary judgment, the court must view the facts in the light most favorable to the non-moving party. State Farm Fire & Cas. Co. v. Martin, 872 F.2d 319, 320 (9th Cir. 1989).

Although the debtors and Finance Factors dispute certain factual issue, the facts that are relevant to the legal issues are undisputed. Thus, the questions presented can be decided as a mater of law.

Finance Factors asks the court to correct the TCTs nunc pro tunc to reflect the FF Mortgage. Section 501-196 of the Hawaii Revised Statues generally provides that no alterations shall be made to a certificate of title except by order of the court. This section also provides that "nothing shall be done or ordered by the court which impairs the title or other interest of a purchaser holding a certificate for value and in good faith, or the purchaser's heirs or assigns, without the purchaser's or their written consent." Haw. Rev. Stat. § 501-196.

Finance Factors asserts that the Land Court's failure to note the FF Mortgage on the TCTs constitutes an error, omission, or mistake, and that the

TCTs must be corrected as a matter of law pursuant to section 501-196. Finance Factors argues that the debtors are not purchasers for value and in good faith whom the proviso of section 501-196 protects. Finance Factors claims that the debtors were not subsequent purchasers for value because there was no consideration for the subsequent transfers of the Mililani property. Finance Factors also alleges that the debtors were not good faith purchasers because they knew that the mortgage encumbered the Mililani property when they transferred the Mililani property among themselves, their revocable living trusts, and their daughter.

The debtors argue that Finance Factors did not have a perfected security interest on the date of petition because the FF Mortgage was omitted from the TCT and, thus, Finance Factors is a general unsecured creditor with no security interest in the Mililani property.[1]

The debtors are not purchasers for value because they gave no consideration when they transferred the Mililani property among themselves. Section 544(a)(3), however, gives the trustee status of a bona fide purchaser as of the commencement of the case.

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[1] The debtors make other arguments based on equitable considerations, which I find unpersuasive in the face of unambiguous statutes.

Section 544(a)(3) provides:

> (a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by –
>
> . . . .
>
> (3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser at the time of the commencement of the case, whether or not such a purchaser exists [and has perfected such transfer].

Pursuant to this section, the trustee has the rights and powers of a bona fide purchaser of real property from the debtor. The trustee can avoid any lien or conveyance that a hypothetical buyer on the petition date could avoid. In re Wiseman, 5 F.3d 417 (9th Cir. 1993).

The extent of the trustee's rights as a bona fide purchaser of real property is measured by the substantive law of the jurisdiction governing the property in question. Under Hawaii state law, "[e]very applicant receiving a certificate of title in pursuance of a decree of registration, and every subsequent purchaser of registered land who takes a certificate of title for value and in good

faith, hold the same free from all encumbrances except those noted on the certificate". Haw. Rev. Stat. § 501-82. The Land Court statute creates a "pure race" recording regime. A bona fide purchaser of registered land takes the property free of all encumbrances that are not noted on the TCT, even if the purchaser has actual or constructive knowledge of them.

Finance Factors argues that, if its mortgage is reinstated nunc pro tunc to correct the Land Court error, the mortgage would be noted on the TCT on the date of the commencement of the debtors' bankruptcy case and, thus, would not be subject to avoidance. This argument would eviscerate section 544. That section is intended to cut off liens that are not perfected as of the commencement of a bankruptcy case. See 5 Collier on Bankruptcy ¶ 544.03 at 544-8 (15th ed. rev. 2003). The failure to perfect a lien is almost always a mistake. Outside of bankruptcy, equity provides remedies to correct mistakes. The use of an equitable remedy to correct an error (retroactively) that resulted in an unperfected lien would undercut section 544.

Finance Factors also asserts that the erroneous omission of its mortgage from the TCTs does not relegate the mortgage to an unregistered status. This is irrelevant. The rights of a bona fide purchaser of registered land depend, not on whether an encumbrance is registered, but whether it is "noted on the

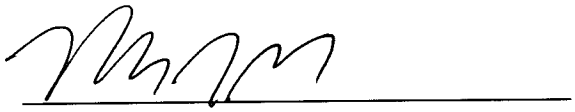
certificate." Haw. Rev. Stat. § 501-82. The FF Mortgage was not noted on the relevant TCT on the date of the bankruptcy.

The trustee is not a party to this case and has not taken steps to avoid the FF Mortgage. The debtors argue that they have standing to assert avoidance actions. I need not reach this issue. It would be wasteful to enter an order correcting a TCT to reflect a lien that the trustee could avoid. The trustee would surely do so because the viability of the debtors' Chapter 13 plan depends almost entirely upon whether Finance Factors' claim is secured or unsecured.

Based on the undisputed facts, the trustee was a bona fide purchaser as of the commencement of this case. The FF mortgage was not noted on the TCT as of the commencement of the case. Every subsequent purchaser of registered land who takes a TCT for value and in good faith holds the property free from all encumbrances except those noted on the TCT. Haw. Rev. Stat. § 501-82. Thus, the court does not have the authority under section 501-196 to order the Land Court to correct the TCTs nunc pro tunc.

Therefore, Finance Factors' motion for summary judgment is denied and the debtor's counter-motion for summary judgment is granted.

DATED: Honolulu, Hawaii, JUL - 9 2003.



Robert J. Faris
United States Bankruptcy Judge