

The Seventh Circuit Rules on Perfection of Liens on Land Contract Vendor's Interests

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Recently, the U.S. Court of Appeals for the Seventh Circuit took on the question of how one properly perfects a lien in a vendor's interest under a land contract. The author of this article discusses the court's decision and its significance.

In a recent decision, *In re Blanchard*,¹ the U.S. Court of Appeals for the Seventh Circuit took on the knotty question of how one properly perfects a lien in a vendor's interest under a land contract. Analyzing Wisconsin statutes and case law, the court observed that in Wisconsin, the question of whether a land contract vendor or vendee owns the property is "troublesome."² The answer fundamentally impacts the rights the vendor has in the underlying real property, and how someone who lends money to the vendor properly perfects its interest to secure repayment. Is the lien an encumbrance to be perfected as an interest in real property under Wisconsin's real estate statutes; an interest in personal property governed by Article 9 of the Uniform Commercial Code;³ or perhaps both?

Facts

In 2010, Troy and Heather Blanchard agreed to sell a residential property under a land contract to Benjamin and Debra Hoffman for \$172,000. The Hoffmans paid \$30,000 down, and the balance of the purchase price was paid

by the Blanchards obtaining a mortgage loan for \$142,000 from Intercity State Bank. Through the combination of the down payment and the proceeds of the mortgage, the Blanchards received the entire \$172,000 purchase price at closing. The Hoffmans intended to pay off the mortgage when they obtained a loan in their own right. The Hoffmans also agreed to pay the Blanchards monthly "rent" of \$500 pursuant to a rental agreement. Neither the land contract nor the rental agreement was recorded with the Marathon County Register of Deeds.

The bank extended the loan to the Blanchards and properly recorded a mortgage granting it a lien in the property, together with all "privileges, hereditaments, easements, and appurtenances, all rents, leases, issues and profits, all claims, awards and payments made as a result of the exercise of the right of eminent domain, all existing and future improvements and all goods that are or are to become fixtures."⁴ The bank also recorded an Assignment of Leases, but mistakenly neglected to obtain an Assignment of Land Contract.

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In 2014, the Blanchards filed for bankruptcy. The Chapter 7 trustee filed an adversary proceeding arguing that, under Section 544(a) (3) of the United States Bankruptcy Code,⁵ the trustee has the rights and powers of a bona fide purchaser of the real property as of the date of the bankruptcy, and therefore stepped in line ahead of the mortgagee. The vendor's interest under the land contract, argued the trustee, is not real property which can be perfected by recording a mortgage under Wisconsin law, but instead is personal property that must be perfected under Article 9 of the UCC, which the bank failed to do.⁶

The Bankruptcy Court and District Court Decisions—A Muddle

The bankruptcy court found that the bank had notice of the land contract and therefore its mortgage was subject to the Hoffman's vendee interest. However, as between the Blanchards' trustee and the bank, the Blanchards' interest as a land contract vendor was an interest in real property subject to the bank's properly recorded mortgage, which could not be avoided.⁷ The trustee appealed and the district court affirmed, but on wholly different grounds.

The district court held that the land contract vendor, as security, held only bare legal title for the right to receive payments under the land contract, which constituted personal rather than real property under Wisconsin law. However, the court found that it was necessary and appropriate to reform the mortgage to constitute a lien on the personal property interest in the land contract payments rather than a real property interest in the land. In reforming the mortgage, the court said that the bank had made a good faith mistake within the "reasonable standards of fair dealing in the residential loan industry"

when it extended the mortgage loan, believing that the Hoffmans were tenants rather than land contract buyers.⁸

The trustee appealed, and the Seventh Circuit, in an opinion authored by Judge David Hamilton, sorted through conflicting Wisconsin precedents, ultimately finding that the bank's mortgage could not be avoided.

Status of a Mortgage on the Land Contract Vendor's Interest

Judge Hamilton began citing the 1897 Wisconsin Supreme Court case of *First National Bank of Stevens Point v. Chafee*,⁹ which held that a mortgage of a land contract vendor's interest was enforceable. This position, said the court, was consistent with general common law. Moreover, the land contract vendor retains legal title to the real property until the land contract is paid.

However, the court also noted that subsequent Wisconsin cases appeared to conflict with this conclusion. In *City of Milwaukee v. Greenberg*,¹⁰ the Wisconsin Supreme Court held that a land contract vendor could not be found liable for the costs of razing a condemned building as the vendor was not the owner. In addition, in *Mueller v. Novelty Dye Works*,¹¹ a creditor of a land contract vendor was not permitted to impose a judgment lien on the real property. These cases suggest that if the land contract vendor's interest was personal property, it would be odd to attach a lien to it by a real estate mortgage. Moreover, under Wisconsin's doctrine of equitable conversion, a land contract vendee obtains equitable title to the property, which includes all incidents of real ownership.¹²

Admitting that the difference between personal property and an interest in real property

is sometimes “metaphysical,”¹³ the court nonetheless found that *Chaffee* had not been overruled, and that *Greenberg* and *Mueller* dealt with different statutes and different purposes. It concluded that the Blanchards’ interest as a land contract vendor was properly subject to the bank’s validly recorded mortgage.¹⁴

Recording the Lender’s Interest

Judge Hamilton agreed with the bankruptcy court that the proper way to perfect the lien on the vendor’s interest was by recording the mortgage with the county register of deeds rather than by filing a financing statement with the Department of Financial Institutions under Article 9 of Wisconsin’s UCC. Wisconsin’s land recording statute applies to *any interest in land*,¹⁵ said the court, and this includes a lien on a vendor’s interest in a land contract.¹⁶

Judge Hamilton found this position bolstered by the 1985 case of *In re Hoeppner*.¹⁷ There, the bankruptcy court for the Eastern District of Wisconsin ruled that a land contract vendor’s interest is perfected when it is recorded in the county land records, and that there was no need to perfect the interest under the UCC. The bankruptcy court found that despite a land contract vendor’s interest being deemed personal property for many purposes, it was also an interest in land excluded from the scope of Article 9 of the UCC.¹⁸ The *Hoeppner* court reasoned that the purpose of the filing system was to make known to the public all security interests in the property of the debtors, and that parties tracing the history of title of a piece of real property should be able to rely on county land records and should not be expected to examine UCC records. The *Hoeppner* court concluded that both the vendor’s interest in a

land contract and the assignment of that interest were excluded from the scope of Article 9.¹⁹

Revised Article 9

The trustee argued that as a result of the 2001 revisions to Article 9 of the UCC, the *Hoeppner* decision was no longer a reliable guide to Wisconsin law. The trustee noted that under current Wisconsin Statutes Section 409.102,²⁰ a mortgage of a vendor’s interest in a land contract was an “account,” which is defined as a right to payment for property which has been sold. This interpretation has been advanced by a number of scholars.²¹ Moreover, Wisconsin Statutes Section 409.308(5) provides that perfection of a security interest under the UCC in a right to payment also perfects a security interest in a security interest, mortgage or other lien on personal or real property securing the right. Scholars argue that this provision alleviates the need to record a transfer of a land contract vendor’s interest in the county real estate records.²²

The court acknowledged that the question of whether a vendor’s interest in a land contract must be perfected as real or personal property varies from state to state.²³ However, Judge Hamilton concluded that the Seventh Circuit did not have to decide whether, in Wisconsin, a financing statement filed under the UCC may properly perfect a lien on a vendor’s interest in a land contract. The only question was whether, under Wisconsin law, the recording of a mortgage may do so.

The court concluded that the answer was yes. Citing the same scholars as the trustee,²⁴ the court said that recording in the real estate records may be desirable even though it is irrelevant under Article 9 of the UCC. More

importantly, Revised Article 9 of the UCC did not restrict the application of Wisconsin Statutes Section 706.001(1), which applies broadly to a mortgage of *any interest in land*. By adopting Revised Article 9 of the UCC while leaving Wisconsin Statutes Section 706.001(1) intact, the Wisconsin legislature did not overturn *Hoepfner*.²⁵ The bank's proper recording of its mortgage interest defeated the trustee's attempt to take the Blanchards' vendor's interest under Code Section 544(a)(3) as a hypothetical bona fide purchaser, or as a hypothetical judicial lien creditor under Code Section 544(a)(1).²⁶

Significance

In *Blanchard*, the Seventh Circuit seems to pick its way through precedents, adopting some while ignoring others, which seem almost as compelling. It adopts the reasoning of *Hoepfner*, which held that both a land contract and any assignment of an interest in the land contract are excluded under Article 9 of the UCC. While the court acknowledges that certain provisions of Revised Article 9 of the UCC enacted after *Hoepfner* conflict with this holding, it seems to brush past this discrepancy without attempting to harmonize the dissonance arising from Wisconsin's real estate recording statute and the UCC.

The decision makes clear that properly recording a mortgage against a Wisconsin vendor's interest in a land contract is sufficient to defeat a bankruptcy trustee's strong-arm powers under the Code. However, it leaves open the question of whether perfection of the same interest under Article 9 of the UCC will do so. In *Blanchard*, the court appears to have left the questions about the nature of ownership interests under land contracts (and liens in these

interests) almost as troublesome as it found them.

NOTES:

¹*In re Blanchard*, 62 Bankr. Ct. Dec. (CRR) 116, 89 U.C.C. Rep. Serv. 2d 512 (7th Cir. 2016).

²*Id.* at *3.

³Wis. Stat. ch 409 [hereinafter, the "UCC"].

⁴*In re Blanchard*, 62 Bankr. Ct. Dec. (CRR) 116, 89 U.C.C. Rep. Serv. 2d 512, 2016 WL 1459568, *4 (7th Cir. 2016).

⁵11 U.S.C.A. §§ 101 to 1532 [hereinafter, the "Code"].

⁶*In re Blanchard*, 62 Bankr. Ct. Dec. (CRR) 116, 2016 WL 1459568, *1, 89 U.C.C. Rep. Serv. 2d 512 (7th Cir. 2016).

⁷*Id.* at *2.

⁸*Id.*

⁹*First Nat. Bank of Stevens Point v. Chafee*, 98 Wis. 42, 73 N.W. 318 (1897).

¹⁰*City of Milwaukee v. Greenberg*, 163 Wis. 2d 28, 471 N.W.2d 33 (1991).

¹¹*Mueller v. Novelty Dye Works*, 273 Wis. 501, 78 N.W.2d 881 (1956).

¹²*In re Blanchard*, 62 Bankr. Ct. Dec. (CRR) 116, 2016 WL 1459568, *3, 89 U.C.C. Rep. Serv. 2d 512 (7th Cir. 2016).

¹³*Id.*

¹⁴*Id.* at *3-4.

¹⁵Wis. Stat. § 706.001(1).

¹⁶*In re Blanchard*, 62 Bankr. Ct. Dec. (CRR) 116, 2016 WL 1459568, *4, 89 U.C.C. Rep. Serv. 2d 512 (7th Cir. 2016).

¹⁷*In re Hoepfner*, 49 B.R. 124, 41 U.C.C. Rep. Serv. 593 (Bankr. E.D. Wis. 1985).

¹⁸*Id.* at 127.

¹⁹*Id.* at 129. See also *In re Szatkowski*, 51 B.R. 104 (Bankr. E.D. Wis. 1985).

²⁰Amended by 2015 WI Act 196 enacted Feb. 24, 2016.

²¹*In re Blanchard*, 62 Bankr. Ct. Dec. (CRR) 116, 2016 WL 1459568, *5, 89 U.C.C. Rep. Serv. 2d 512 (7th Cir. 2016).

²²*Id.* at *6. The court noted that Greenberg distinguished a mortgagee, who has alien on property of the type described by UCC Section 409.308(5), and a land contract vendor, who holds legal title, not a lien.

²³*Id.* at n. 2.

²⁴Grant S. Nelson et al., Real Estate Finance Law (6th Ed. 2014).

²⁵*In re Blanchard*, 62 Bankr. Ct. Dec. (CRR) 116, 2016 WL 1459568, *5, 89 U.C.C. Rep. Serv. 2d 512 (7th Cir. 2016).

²⁶The court also dismissed the trustee's claim that the district court erred in reforming the mortgage. Because the decision of the bankruptcy court was correct, there was no need to reform the mortgage. *Id.* at *8.