

1

A07-645
State of Minnesota
In Court of Appeals

Evelyn I. Rechtzigel Trust, by its Trustees
Frank Rechtzigel and Gene Rechtzigel,

Appellant,

vs.

Fidelity National Title Insurance
Company of New York, and Pulte Title
Agency of Minnesota, L.L.C.

Respondents.

Brief of Appellant

Evelyn I. Rechtzigel Trust, by its Trustees
Frank Rechtzigel and Gene Rechtzigel

Erick G. Kaardal
Atty Lic. No. 229647
Mohrman & Kaardal, P.A.
33 S 6th St. Suite 4100
Minneapolis, Minnesota 55402

*Attorney for Appellant
Evelyn I. Rechtzigel Trust,
by its Trustees Frank Rechtzigel
and Gene Rechtzigel*

Brian M. Sund
Atty Lic. No. 198213
Morrison Fenske & Sund, P.A.
5125 County Road 101, Suite 202
Minnetonka, Minnesota 55345

*Attorney for Respondent
Fidelity National Title
Insurance Company of New York*

Charles W. Arndt
Atty Lic. No. 299431
Wilkerson & Hegna, LLC
One Corporate Center III, Suite 300
Edina, MN 55439-2302

*Attorney for Respondent
Pulte Title Agency of
Minnesota, LLC*

TABLE OF CONTENTS

TABLE OF AUTHORITIES.....	iv
STATEMENT OF THE ISSUES.....	ix
STATEMENT OF THE CASE.....	1
Relief Requested.....	3
STATEMENT OF THE FACTS.....	3
1. Services are secured with Pulte Title Agency and Like-Kind Exchange Services to effect a § 1031 like-kind real estate transaction.....	3
2. The Trust, to effect the § 1031 transaction, assigned to LKE the “rights, title, and interest” to the properties sold and purchased in Apple Valley and Jackson County.....	5
3. Pulte offers and the Trust purchases a 1987 ALTA title insurance policy for the § 1031 real estate transaction through a policy commitment.....	5
4. Although the trust purchased a 1987 ALTA policy, over two months later Pulte and Fidelity issued a 1992 ALTA policy to the Trust with exceptions from coverage not previously bargained for.....	6
5. LKE files for bankruptcy and the bankruptcy trustee sues the Trust for recovery of “the property, or the value of the property” and Fidelity refuses to defend or cover the Trust.....	8
INTRODUCTION.....	10
SUMMARY OF ARGUMENT.....	10
LEGAL ARGUMENT AND AUTHORITIES.....	12
A. Under U.S.C. §§ 547 and 550, when a bankruptcy complaint seeks to recover “the property, or the value of the property” in a preference action, it constitutes a threat, lien, or encumbrance on the subject property’s title.....	12

1. The Trust entered into a legitimate and favored tax deferred like-kind land transaction under 26 U.S.C. § 1031 transferring title of the sold and purchased properties to a qualified intermediary.....	13
(i). A § 1031 safe harbor — a qualified intermediary.....	13
(ii). The Trust and LKE transfer property titles through a contract.....	14
Chart — 26 U.S.C. § 1031 Like-Kind Land Exchange	18
2. Under 11 U.S.C. §§ 547 and 550 the bankruptcy trustee has the authority to avoid the Trust’s property transfer with LKE, thus recover the “property, or the value of the property.”.....	18
3. The bankruptcy trustee, if the court so orders, may recover the property transferred, thus implicating the Trust’s Jackson County replacement property clouding its title.....	23
(i). The lower court did not fully appreciate the bankruptcy court’s discretion to recover property or its value and thus the threat to property title.....	23
(ii). The lower court did not fully appreciate the significance of LKE’s and the Trust’s contract assigning all title and interest in the Jackson County property to LKE.....	26
B. The Bankruptcy Complaint’s demand for avoidance and recovery of the Trust’s property is a threat, lien, or encumbrance on the Trust’s property title, events that trigger the duty to defend the insured.....	29
1. The Trust purchased a 1987 title insurance policy that insured against “threats, liens, or encumbrances” to property title.....	29
(i). The Trust purchased a 1987 ALTA policy through a contract with Pulte, an agent of Fidelity.....	30
(ii). The 1987 ALTA policy covered the property transaction.....	32
(iii). Fidelity had a duty to defend the Trust.....	39

C. When Pulte agreed to provide the Trust with a 1987 ALTA title insurance policy and later, Fidelity delivered a 1992 policy with coverage different than initially purchased, both Pulte and Fidelity breached their contracts with the Trust.....	43
1. The Trust contracted for a 1987 title insurance policy.....	44
2. The Trust suffered damages because of Fidelity’s and Pulte’s breach of contract.....	46
D. The Trust originally purchased a title insurance policy that covered threats to property title arising from bankruptcy actions, but when Pulte and Fidelity failed to inform the Trust of the substitution of that policy they committed acts of negligent misrepresentation.....	47
1. Pulte and Fidelity owed a duty of care to the Trust regarding the title insurance policy purchased.....	47
2. Pulte and Fidelity failed to tell the Trust of the substitutions of title insurance policies.....	49
CONCLUSION.....	50

TABLE OF AUTHORITIES

	Page
Federal Statutes:	
11 U.S.C. §101 (54).....	20
11 U.S.C. § 102 (5).....	25
11 U.S.C. § 544 (a)(3).....	15
11 U.S.C. § 547.....	passim
11 U.S.C. § 547(b).....	19, 21, 22
11 U.S.C. § 550.....	passim
11 U.S.C. § 550 (a).....	20, 23
11 U.S.C. § 550 (a)(1) and (2).....	25
11 U.S.C. § 550 (b).....	25
11 U.S.C. § 550 (c).....	25
11 U.S.C. § 550 (d).....	23, 25
11 U.S.C. § 550 (e).....	25
11 U.S.C. § 551.....	33
26 C.F.R. § 1.1031(k)-1(a)-(o).....	5
26 C.F.R. § 1.1031 (k)-1.....	14
26 C.F.R. § 1.1031 (k)-1(b)(ii)(2).....	14
26 C.F. R. §1.1031(k)-1(b)(3).....	14
26 C.F.R. §§1.1031(k)-1(g)(2).....	14
26 C.F.R. §1.1031(k)-1(g)(3).....	14

26 C.F.R. §1.1031(k)-1(g)(4).....	14
26 C.F.R. §1.1031(k)-1(g)(4)(iii).....	14
26 C.F.R. §1.1031(k)-1(g)(4)(vi).....	14
26 C.F.R. §1.1031(k)-1(g)(5).....	14
26 C.F.R. § 1.031 (k)-1(g)(6).....	17
26 U.S.C. § 1031.....	passim
26 U.S.C. § 1031 (a)(3).....	4, 13

State Statutes:

Minn. Stat. §§ 513.41-513.51.....	21
Minn. Stat. § 548.09, subd. 1 (2004).....	26
Minn. Stat. § 60A.951, subd. 4a.....	30
Minn. Stat. § 60A.951, subd. 4c.....	30

Federal Cases:

<i>Alderman v. C.I.R.</i> , 317 F.2d 790 (9 th Cir. 1963).....	16
<i>America Sav. & Loan Ass'n v. Lawyers Title Ins. Corp.</i> , 793 F.2d 780 (6 th Cir. 1986).....	38
<i>Barnill v. Johnson</i> , 503 U.S. 393 (1992).....	21
<i>Begier v. IRS</i> , 496 U.S. 53 (1990)	21
<i>Durrett v. Washington Nat'l Ins. Co.</i> , 621 F.2d 201 (5 th Cir. 1980).....	22
<i>In re Acequia, Inc.</i> , 34 F.2d 800 (9 th Cir. 1994).....	23
<i>In re Burns</i> , 322 F.2d 421 (6 th Cir. 2003).....	19, 23
<i>In re Carrozzella & Richardson</i> , 302 B.R. 415 (Bankr. D.C. Conn. 2003).....	25

<i>In re Centennial Textiles, Inc.</i> , 39 B.R. 165 (Bankr. S.D.N.Y. 1998).....	24
<i>In re C.F. Foods, L.P.</i> , 265 B.R. 71 (Bankr. E.D. Pa. 2001).....	25
<i>In re Da-Sota Elevator Co.</i> , 939 F.2d 654 (8 th Cir. 1991).....	25
<i>In re DLC, Ltd.</i> , 295 B.R. 593 (8 th Cir. BAP 2003).....	20
<i>In re Exchange Titles, Inc.</i> , 159 B.R. 303 (Bankr. C.D. Cal. 1993).....	15
<i>In re H & S Transp. Co.</i> , 939 F.2d 355 (6 th Cir. 1991).....	19
<i>In re Handsco Distributing, Inc.</i> , 32 B.R. 358 (Bankr. S.D. Ohio 1983).....	24
<i>In re Hill</i> , 342 B.R. 183 (Bankr. D. N.J. 2006).....	20
<i>In re Jameson’s Foods, Inc.</i> , 35 B.R. 433 (Bankr. D. S.D. 1983).....	23
<i>In re Kelton Motors, Inc.</i> , 97 F.3d 22 (2 nd Cir. 1996).....	21
<i>In re Mako, Inc.</i> , 127 B.R. 471 (Bankr. E.D. Okl. 1991).....	19
<i>In re Nation-Wide Exchange Services, Inc.</i> , 291 B.R. 131 (Bankr. D. Minn. 2003).....	27, 28
<i>In re Schauer</i> , 835 F.2d 1222 (8 th Cir. 1987).....	28
<i>In re Smith</i> , 966 F.2d 1527 (7 th Cir. 1992).....	21
<i>In re Vann</i> , 26 B.R.148 (Bankr. S.D. Ohio 1983).....	25
<i>In re Vedaa</i> , 49 B.R. 409 (Bankr N.D. 1985).....	24
<i>In re Willaert</i> , 944 F.2d 463 (8 th Cir. 1991).....	23
<i>John Deere Ins. Co. v. Shamrock Indus., Inc.</i> , 929 F.2d 413 (8 th Cir. 1991).....	40
State Cases:	
<i>Am. Family Ins. Co. v. Walser</i> , 628 N.W.2d 605 (Minn. 2001).....	32
<i>American Std. Ins. Co. v. Le</i> , 551 N.W.2d 923 (Minn. 1996).....	47
<i>Alpha Real Estate v. Delta Dental Plan, Minn.</i> , 664 N.W.2d 303 (Minn. 2003).....	43

<i>Associated Cinemas of America v. World Amusement Co.</i> , 201 Minn. 94, 276 N.W.2d 7, (1937).....	46
<i>Atwater Creamery Co. v. Western National Mutual Ins. Co.</i> , 366 N.W.2d 271 (Minn. 1985)....	32, 36
<i>Auto-Owners Ins. Co. v. Todd</i> , 547 N.W.2d 696 (Minn. 1996).....	42
<i>Blackburn, Nickels & Smith, Inc.</i> , 366 N.W.2d 640 (Minn. App. 1985).....	29
<i>Bonhiver v. Graff</i> , 311 Minn. 111, 122, 248 N.W.2d 291 (1976).....	48
<i>Borgersen v. Cardiovascular Systems, Inc.</i> , 729 N.W.2d 619 (Minn. App. 2007).....	43
<i>Cederstrand v. Lutheran Bhd.</i> , 263 Minn. 520, 532, 117 N.W.2d 213 (1962).....	43
<i>Davis v. OutCNHrd Marine Corp.</i> , 415 N.W.2d 719 (Minn. App. 1987).....	44
<i>Fin Ag, Inc. v. Hufnagle, Inc.</i> , 720 N.W.2d 579 (Minn. 2006).....	12
<i>Florenzano v. Olson</i> , 387 N.W.2d 168 (Minn. 1986).....	48
<i>Flynn v. Sawyer</i> , 272 N.W.2d 904 (Minn. 1978).....	45
<i>Franklin v. Western Nat'l Mut. Ins. Co.</i> , 574 N.W.2d 405 (Minn. 1998).....	38, 39
<i>Garvis v. Employers Mut. Cas. Co.</i> , 497 N.W.2d 254 (Minn. 1993).....	40
<i>Glasser v. Minnesota Federal Sav. & Loan Ass'n</i> , 389 N.W.2d 763 (Minn. App. 1986).....	15
<i>Hebrink v. Farm Bureau Life Ins. Co.</i> , 664 N.W.2d 414 (Minn. App. 2003).....	48
<i>Hook v. Northwest Thresher Co.</i> , 91 Minn. 482, 98 N.W. 463 (1904).....	15, 26
<i>In re Butler</i> , 552 N.W.2d 226 (Minn. 1996).....	21, 22
<i>Jensen v. Duluth Area YMCA</i> , 688 N.W.2d 574 (Minn. App. 2004).....	44
<i>Johnson v. Farmers & Merchants State Bank</i> , 320 N.W.2d 892 (Minn. 1982).....	48
<i>Josten's, Inc. v. Mission Ins. Co.</i> , 387 N.W.2d 161 (Minn. 1986).....	40
<i>Meadowbrook, Inc. v. Tower Ins. Co.</i> , 559 N.W.2d 411 (Minn. 1997).....	39
<i>Melin v. Johnson</i> , 387 N.W.2d 230 (Minn. App. 1986).....	48

<i>Morrisette v. Harrison</i> , 486 N.W.2d 424 (Minn. 1992).....	43
<i>Reinsurance Ass'n of Minnesota v. Timmer</i> , 641 N.W.2d 302 (Minn. App. 2002).....	32, 39
<i>SCSC Corp. v. Allied Mut. Ins. Co.</i> , 536 N.W.2d 305 (Minn. 1995).....	32, 42
<i>State Farm Ins. Cos. V. Seefeld</i> , 481 N.W.2d 62 (Minn. 1992).....	29
<i>State v. Grimes</i> , 46 P.3d 801 (Wash. App. 2002).....	16
<i>Tshchimperle v. Aetna Cas. & Sur. Co.</i> , 529 N.W.2d 421 (Minn. App. 1995).....	40
<i>Turner v. Alpha Phi Sorority House</i> , 276 N.W.2d 63 (Minn. 1979).....	44
<i>Yartz v. Dahl</i> , 367 N.W.2d 616 (Minn. 1985).....	31
<i>Zimmerman v. Safeco Ins. Co. of America</i> , 605 N.W.2d 727 (Minn. 2000).....	12, 29, 47

Other:

Lawrence P. King, Alan N. Resnick, Henry J. Sommer, <i>Collier on Bankruptcy</i> , vol. 5, § 547.01 (5 th ed., Matthew Bender & Company, Inc. 2006).....	20, 21
<i>Restatement (Second) of Torts</i> § 552 (Tent. Draft No. 12 1966).....	48
Robert E. Keeton, <i>Insurance Law Rights at Variance with Policy Provisions</i> , 83 Harv. L. Rev. 961, 967 (1970).....	36
S.Rep.No. 989, 95 th Cong., 2d Sess. 27 (1978).....	20

STATEMENT OF THE ISSUES

I. Under 11 U.S.C. §§ 547 and 550, when a bankruptcy trustee complaint seeks to recover “the property, or the value of the property” in a preference action, it constitutes a threat, lien, or encumbrance on the subject property’s title.

The lower court determined that the bankruptcy trustee’s complaint sought only monetary relief and because neither the title insurance policy initially purchased nor the different policy later actually issued covered risks for money judgments, there were no defects in the property title.

Apposite Statutes:

11 U.S.C. §§ 547 and 550;
26 U.S.C. § 1031.

Apposite Cases:

In re Exchange Titles, Inc., 159 B.R. 303 (Bankr. C.D. Cal. 1993);
Glasser v. Minnesota Federal Sav. & Loan Ass’n, 389 N.W.2d 763 (Minn. App. 1986);
In re Mako, 127 B.R. 471 (Bankr. E.D. Okl. 1991);
In re DLC, Ltd., 295 B.R. 593 (8th Cir. BAP 2003);
In re Hill, 342 B.R. 183 (Bankr. D. N.J. 2006);
In re Butler, 552 N.W.2d 226 (Minn. 1996);
In re Willaert, 944 F.2d 463 (8th Cir. 1991);
In re Vedaa, 49 B.R. 409 (Bankr. N.D. 1985);
In re Nation-Wide Exchange Services, Inc., 291 B.R. 131 (Bankr. D. Minn. 2003).

II. The bankruptcy trustee’s complaint asserted a cause of action for the recovery of “the property or the value of the property.” The bankruptcy action involved the intermediary of the like-kind exchange of land under 26 C.F.R. § 1031. The possible threat, lien, or encumbrance of the bankruptcy trustee’s action on the subject property is sufficient to trigger the insurer’s duty to defend the insured.

The lower court characterized the 26 C.F.R. § 1031 exchange as a “very poor financial decision” because of the risk the land-exchange intermediary could go bankrupt and, since the title insurance policies do not insure against the

solvency of the parties involved in a real estate transaction the insurer has no duty to defend the insured.

Apposite Statutes:

26 C.F.R. § 1031

Apposite Cases:

Atwater Creamery v. Western Nat'l Mut. Ins., 366 N.W.2d 271 (Minn. 1985);
America Sav. & Loan Ass'n v. Lawyers Title Ins. Corp., 793 F.2d 780 (6th
Cir. 1986);

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Reinsuarnee Assoc., 641 N.W.2d 302 (Minn. App. 2002);

Tshchimperle v. Aetan Cas. & Sur. Co., 529 N.W.2d 421 (Minn. App.
1995);

Auto-Owners Ins. Co. v. Todd, 547 N.W.2d 696 (Minn. 1996)

III. A commitment agreement to purchase a specific title insurance policy is a contract to ensure the purchaser obtains what is bargained for to cover title defects. When the title insurance company delivers a different policy than what is initially purchased, and contains exceptions otherwise allowed in the initially purchased policy, the title insurance company breached its contract with the purchaser.

Because the lower court determined that neither the title insurance policy initially purchased nor the different policy later actually issued covered risks for claimed defects in title, the court did not adjudicate issues relating to breach of contract.

Apposite Cases:

Davis v. Out CNHrd Marine Corp., 415 N.W.2d 719 (Minn. App. 1987);
Associated Cinemas of America v. World Amusement Co., 201 Minn. 94, 276
N.W.2d 7 (1937)

IV. The insured sought title insurance for a like-kind land transaction under 26 C.F.R. § 1031. The insurer, a promoter of §1031 exchanges and its' agent, knew of the land transaction at the time the insured entered into a title commitment agreement. When the insurer forwarded a policy different than that initially purchased under the title commitment and thereafter failed to provide coverage for litigation

involving the §1031 property transaction, it committed negligent misrepresentation.

The lower court determined the insurer never made a representation to cover a § 1031 real estate transaction and neither the title insurance policy initially purchased nor the different policy later actually issued, covered § 1031 land exchange transactions.

Apposite Cases:

Florenzano v. Olson, 387 N.W.2d 168 (Minn. 1986);

Hebrink v. Farm Bureau Life Ins. Co., 664 N.W.2d 414 (Minn. App. 2003);

Johons v. Farmers & Merchants State Bank, 320 N.W.2d 892 (Minn. 1982).

STATEMENT OF THE CASE

The Appellant Evelyn I. Rechtzigel Trust (the "Trust") entered into a 26 C.F.R. § 1031 like-kind land exchange transaction for the purpose of acquiring real property. The Trust entered into a contract with the Respondents Pulte Title Agency of Minnesota, L.L.C., and Fidelity National Title Insurance Company of New York, for a specific title insurance policy referred to as the "1987 ALTA policy" to ensure the property the Trust acquired in the like-kind exchange¹. Over two months after the Trust acquired the property in the like-kind transaction, Fidelity delivered, not the 1987 ALTA policy purchased, but a different policy referred to as the "1992 ALTA policy." The difference between the policies involved a key provision: the 1992 policy contained a "creditor's rights exception;" the 1987 policy did not.

After the successful § 1031 like-kind land transaction, the intermediary entity, Like-Kind Exchange Services, Inc. ("LKE"), filed for Chapter 7 bankruptcy protection. The United States, through the bankruptcy trustee, later sued the Trust for "the property, or the value of the property" LKE transferred to the Trust under 11 U.S.C. §§ 547 and 550 as a preference action because the land transaction occurred within 90 days of LKE's bankruptcy filing. The Trust settled the litigation for \$102,412.20.

When the bankruptcy trustee commenced its lawsuit, the Trust filed a claim with Fidelity. The Trust based its claim on the allegations asserted in the bankruptcy trustee's complaint. The complaint's allegations and demands for "the property, or the value of the

¹ "ALTA" refers to the American Land Title Association, a national trade association that develops title insurance policy forms.

property” constituted a threat, lien, or encumbrance on the property title of the land exchanged in the § 1031 real estate transaction.

Fidelity refused to defend the Trust against the litigation claiming Fidelity had no obligation to pay for any damages associated with the like-kind exchange land transaction. Fidelity asserted that the 1992 ALTA policy delivered to the Trust — but not purchased by the Trust — did not cover the like-kind land transaction or subsequent bankruptcy litigation under the “creditor’s rights exception” provision of the 1992 ALTA policy.

The Trust then commenced a lawsuit against Pulte and Fidelity. Pulte assisted in the closing of the § 1031 land transaction and with whom the Trust contracted for the 1987 ALTA policy through a title commitment agreement. The Trust sued for breach of contract, failure to defend and indemnify, and for negligent misrepresentation among other claims. The Trust also sought attorney fees for the bankruptcy litigation and the current district court action against Pulte and Fidelity.

The district court denied the Trust’s motion for summary judgment and granted Fidelity’s and Pulte’s motions for summary judgment. The court opined that the threshold issue of breach of contract need not be reached since neither the 1987 nor the 1992 ALTA policy covered the Trust’s claimed title defect. The court asserted that the bankruptcy trustee’s complaint sought only monetary relief — a claim the policies did not cover — not recovery of the land subject to the § 1031 like-kind exchange.

The court further determined that because the bankruptcy trustee’s complaint did not implicate the Trust’s property, there was no defect in or lien or encumbrance on the title, unmarketability of the title, or lack of a right of access to and from the land — therefore, no

title defect. Following the court's own logic it found the Trust's arguments regarding claims of failure to defend, negligent misrepresentation, bad faith, and illusory contract without merit.

The Trust then filed this appeal.

RELIEF REQUESTED

The Trust seeks reversal of the lower court's decision. In the alternative, the Trust seeks reinstatement of its complaint for trial to resolve all material issues of fact and, judgment in accordance with this Appellate Court's decision on the law.

STATEMENT OF THE FACTS

1. Services are secured with Pulte Title Agency and Like-Kind Exchange Services to effect a § 1031 like-kind real estate transaction.

The Appellant Evelyn I. Rechtzigel Trust, by its trustees Frank Rechtzigel and Gene Rechtzigel ("the Trust"), agreed to sell land in Apple Valley, Minnesota to a developer, Pulte Homes of Minnesota Corporation.² To defer tax consequences of the sale, the Trust decided to engage in a land-for-land, like-kind real estate transaction under 26 U.S.C. § 1031.³ In accordance with the federal regulations governing § 1031 like-kind exchanges, the Trust secured the services of Like-Kind Exchange Services, "A Qualified Intermediary Service for Tax Deferred § 1031 Exchanges" ("LKE") to act as the statutorily required intermediary.⁴

² Appellant's Appendix p. 27 ("App. p. ---") Deposition of Joan Young at pp.34-35 ("Young Depo. at ----").

³ App. p. 61; Deposition of Gene Rechtzigel at pp. 38-39 ("Rechtzigel Depo. at p. ----")

⁴ App. p. 60-61 (Rechtzigel Depo. at pp. 35-37); App. pp. 128-131.

The Trust also engaged the services of the Respondent Pulte Title Agency of Minnesota, LLC (“Pulte”) as the closing manager for both the relinquished and replacement properties of the like-kind real estate transaction.⁵ Pulte, through Joan Young, had handled other previous land transactions between the Trust and Pulte Homes of Minnesota.⁶ Young also had previous experiences in § 1031 transactions having handled between 30 and 50 transactions.⁷

After the sale of the Apple Valley property to Pulte Homes of Minnesota, phase three of the § 1031 transaction,⁸ Pulte transferred sale proceeds in the amount of \$600,000⁹ to LKE for the specific and sole purpose of purchasing the replacement property—the second part of the § 1031 transaction.¹⁰ The Apple Valley property is referred to as the “relinquished property.”¹¹ Within 45 days of the first transaction, the Trust identified land in Jackson County to be purchased through LKE as the § 1031 land-for-land transaction (“Jackson Property”).¹² The Jackson Property is referred to as the “Replacement Property.”¹³ The completed § 1031 and last phase of the transaction occurred on February 28, 2000.¹⁴

⁵ App. p. 25-24 (Young Depo. at pp. 28-29).

⁶ App. p. 54 (Rechzigel Depo. at pp. 9-12); App. p. 25 (Young Depo. at p. 28).

⁷ App. p. 28 (Young Depo. at p. 40).

⁸ Phases one and two were part of a previous successful § 1031 like-kind land transactions.

⁹ The actual final purchase price at closing and for the amount insured when the Trust purchased title insurance was \$589,864.82. App. pp. 136; 137-142.

¹⁰ App. p. 41 (Young Depo. at p. 89); see also, App. p. 129 referencing the Apple Valley property as part of the § 1031 transaction.

¹¹ App. p. 129.

¹² App. pp. 134-135.

¹³ App. p. 129.

¹⁴ The Trust received the replacement property within the 180 day period required upon the transfer of the relinquished property under 26 U.S.C. § 1031(a)(3).

- 2. The Trust, to effect the § 1031 transaction, assigned to LKE the “rights, title, and interest” to the properties sold and purchased in Apple Valley and Jackson County.**

The Trust entered into an agreement with LKE for LKE to acquire title to the Trust’s Relinquished Property in Apple Valley and the Replacement Property in Jackson County in order to effect the § 1031 like-kind transaction.¹⁵ Specifically, the Trust assigned “all of [its] *rights, title, and interest* in and to the certain [Jackson County Property] Purchase and Sale Agreement, and certain of his obligations thereunder to [the] Intermediary.”¹⁶

The Agreement between LKE and the Trust further decreed the obligations between the parties. For instance, to avoid duplication of transfer fees, escrow costs, and other similar expenses, the Trust and LKE agreed “to make any deed transfer . . . conveying title to the property directly to the intended transferee. Thus, on appropriate escrow instructions, title to the replacement property shall be conveyed directly from Seller to Exchangor.”¹⁷ Pulte knew, through the Agreement and as a participant in the Jackson County exchange closing, of the terms and obligations between the Trust and LKE for the §1031 exchange¹⁸ as did the seller of the Jackson County property.¹⁹

- 3. Pulte offers and the Trust purchases a 1987 ALTA title insurance policy for the § 1031 real estate transaction through a policy commitment.**

The §1031 like-kind land transaction closing of the Replacement Property occurred on February 28, 2000. Young, on behalf of Pulte, offered the Trust title insurance which the

¹⁵ App. pp. 128-131; 26 C.F.R. § 1.1031(k)-1(a)-(o).

¹⁶ App. p. 130 (emphasis added); Preceding the quoted phrase is the word “conditionally.” As the agreement indicates, “conditionally” refers to the Trust performing its obligations as an Exchangor.

¹⁷ App. p. 130 at ¶ 2(a).

¹⁸ App. pp. 128-131.

¹⁹ App. 132.

Trust accepted and paid for.²⁰ Young gave to the Trust a “Commitment” for a policy to be issued identified as “ALTA Residential Owner’s Policy – 1987.”²¹ A Commitment is “a commitment to issue a policy in the manner as set forth in the commitment....”²² Schedule B of the Commitment also required the Trust to disclose “the name of anyone not referred to in this Commitment who will get an interest in the land”²³ The Trust met its obligation through the LKE § 1031 documentation and agreement.²⁴

According to the testimony of Fidelity’s Vice-President and Regional Counsel, because the Commitment identified the 1987 ALTA title insurance policy, Fidelity would have issued the 1987 policy.²⁵ The 1987 ALTA policy provided coverage for, among other things, “[o]ther defects, liens, and encumbrances.”²⁶ And, there is nothing in the policy that excludes coverage of a § 1031 like-kind real estate transaction or excludes coverage for events related to bankruptcy actions.²⁷

4. Although the Trust purchased a 1987 ALTA policy, over two months later Pulte and Fidelity issued a 1992 ALTA policy to the Trust with exceptions from coverage not previously bargained for.

Pulte, on May 12, 2000 — two months after the closing — forwarded to the Trust a title insurance policy identified in a transmittal form letter simply as “[o]wner’s policy 5312-

²⁰ App. p. 136; App. pp. 27-28 (Young Depo. at pp. 34; 37-40).

²¹ App. pp. 137-141.

²² App. p. 99; (Deposition Transcript of Paul C. Cozzi, Fidelity’s Vice-President and Regional Counsel, at p. 22 (“Cozzi Depo. at p. ----”).

²³ App. p. 138 (Schedule B – Section I, (c)).

²⁴ App. pp. 128-131.

²⁵ App. p. 98 (Cozzi Depo. at pp. 18-19).

²⁶ App. p. 144.

²⁷ App. pp. 142-150.

802094.”²⁸ Pulte nor Fidelity delivered to the Trust the purchased 1987 ALTA policy, but instead delivered a 1992 ALTA policy.²⁹ The only identifier of the policy as an “ALTA owner’s policy – 1992(10-17-92)” is found in the lower right hand corner of the first page of the document.³⁰

Neither Pulte’s May transmittal letter nor the delivered Fidelity policy advised the Trust of a substitution of the February purchased 1987ALTA title insurance policy. Furthermore, Pulte never offered to the Trust any alternative policy other than the 1987 ALTA policy.³¹

The 1992 ALTA policy contained a creditors rights exclusion from coverage:

4. Any claim which arises out of the transaction vesting in the Insured the estate or interest insured by this policy, by reason of federal bankruptcy, state insolvency, or similar creditor rights law that is based on:

(ii) the transaction creating the estate or interest insured by this policy being deemed a preferential transfer except where the preferential transfer results from the failure:

- (a) to timely record the instrument of transfer; or
- (b) of such recordation to impart notice to a purchaser for value or a judgment lien creditor.³²

The 1987 ALTA policy does not have these exclusions.

²⁸ App. p. 157A.

²⁹ App. pp. 151-157.

³⁰ App. p. 151.

³¹ App. p. 31 (Young Depo. at p. 49).

³² App. p. 152.

5. LKE files for bankruptcy and the bankruptcy trustee sues the Trust for recovery of “the property, or the value of the property” and Fidelity refuses to defend or cover the Trust.

LKE filed for Chapter 7 bankruptcy protection in April of 2000. Soon after, the United States through a bankruptcy trustee, sued the Trust for “the property, or the value of the property” under 11 U.S.C. §§ 547 and 550 of the United States Bankruptcy Code as a preference action because the like-kind land transaction occurred within 90 days of LKE’s bankruptcy filing.³³

The Bankruptcy’s Complaint identified the role of LKE:

[T]he Debtor [LKE] and individuals and/or businesses would enter into a series of written agreements designed to allow the “Exchangor” (hereinafter referred to as “the Defendant” and/or the “Exchangors” [the Trust]) to sell real property and avoid tax consequences for such sale by *assigning all rights to the property and proceeds* to the Debtor (Intermediary [LKE]). The Debtor would then hold the sale proceeds to until the Exchangors directed the payment of funds in connection with the purchase of another parcel of property.³⁴

The Bankruptcy Complaint identified one claim for relief under 11 U.S.C. §§ 547 and 550 — governing preferential transfers. And, under 11 U.S.C. §§ 550 and 551, the Bankruptcy Complaint asserted that the bankruptcy “Trustee may recover, for the benefit of the estate, the property or the value of the property transfer to the Defendant.”³⁵ The bankruptcy trustee demanded a judgment against the Trust for \$602,424.76 and for all other costs and attorney fees.³⁶

³³ App. pp. 161-166. (“Bankruptcy Complaint at ¶ -----”).

³⁴ App. p. 162; (Bankruptcy Complaint at ¶ 7 (emphasis added)).

³⁵ App. p. 163 (Bankruptcy Complaint at ¶ 20.)

³⁶ App. p. 164 (Bankruptcy Complaint at “Wherefore” clause.)

The Trust tendered the claim to Fidelity seeking assistance from the insurer to defend the Trust from the preference action.³⁷ Fidelity refused.³⁸ Fidelity denied coverage asserting four theories, three of which specifically related to the terms of the 1992 ALTA policy. Fidelity asserted that a “creditor rights exception” excluded coverage; that the policy covered only “defects to title;” and finally, claimed the Bankruptcy Complaint sought monetary damages, a claim not covered by the policy.³⁹ Fidelity’s fourth theory asserted that the actions of the Trust created a preference because the Trust used LKE for the § 1031 like-kind transaction.⁴⁰

Because Fidelity refused to defend the Trust, the Trust settled the matter “under duress ... for \$102,412.20.”⁴¹

The Trust later sued Pulte and Fidelity for breach of contract — duty to cover and duty to defend — negligent representation, illusory contract, and bad faith. The Trust sought monetary relief of the settlement amount and all attorney fees and costs for the proceeding concerning the Bankruptcy Complaint, and for the present proceeding.⁴²

In cross motions for summary judgment, the lower court denied the Trust’s motion, but granted those of both Pulte and Fidelity. The district court found that neither the 1987 nor 1992 ALTA policies covered the Trust’s claimed title defect since the Bankruptcy’s Complaint sought only monetary relief. The court further determined that since the

³⁷ App. pp. 170; 171; 172-73; 176-79; 180-81.

³⁸ App. pp. 185-86; 187-93; 194.

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ App. p. 184.

⁴² Complaint, Evelyn I. Rehtzigel Trust, by its Trustees vs. Fidelity National Title Insurance Company of New York, and Pulte Title Agency of Minnesota, LLC; District Court File No. 19-C-5-05-6764.

Bankruptcy Complaint did not implicate the Trust's property, there could not be a threat, defect, lien, or encumbrance on the Trust's replacement property title. Accordingly, the lower court dismissed the Trust's remaining claims against Fidelity and Pulte and dismissed the Trust's Complaint.

INTRODUCTION

SUMMARY OF ARGUMENT

A purchaser of title insurance expects coverage for events that affect clear title to the property purchased. There is also a reasonable expectation that the insurer will defend the insured when an event threatens the title of the property. Furthermore, the insured's expectation includes the receipt of the purchased policy and not a substitute of the insurer's choice that provides terms different than that of the originally purchased policy.

The Trust entered into a like-kind real estate transaction pursuant to governing federal internal revenue statutes and regulations. The qualified intermediary held title to the properties sold and purchased to effect the like-kind land transaction and later went into bankruptcy.

A bankruptcy trustee's authority to make whole creditors after the intermediary's bankruptcy extends to the avoidance of previous transactions. Statutes further provide the bankruptcy trustee with the available remedies to recover the targeted real property of the previous transaction or, with court approval, its value. The threat of either remedy is a threat to the title of the targeted real property.

The insurer, Fidelity, understood the remedies available to the bankruptcy trustee through the Bankruptcy Complaint's cited statutory provisions allowing for the recovery of

“the property, or the value of the property.”⁴³ Because the trustee could avoid the transfer and seek recovery of the Trust’s real property involved in the like-kind transaction, Fidelity knew that the bankruptcy trustee created a “defect[], lien[], and encumbrance[]” of the title triggering its duty to defend the Trust under the purchased 1987 ALTA title insurance policy. It also had a duty to cover monetary damages to the Trust under the same policy.

Fidelity failed to defend or cover the Trust. Pulte, Fidelity’s agent, failed to deliver to the Trust the 1987 ALTA policy the Trust paid for, breaching its commitment contract with the Trust. Likewise, Fidelity breached its contract with the Trust, failing to deliver the purchased 1987 policy.

The result of a legitimate business transaction governed under federal law, covered in the normal business practice of procuring title insurance, left the Trust to fend for itself and suffer damages because Fidelity refused to meet its contractual obligations to the Trust. Fidelity created an illusory contract. Fidelity had a duty to defend and to cover and refused to do so. And both Fidelity and Pulte made misrepresentations to the Trust, claiming the availability of a 1987 ALTA policy, but two months after the closing, delivering a 1992 policy never bargained for. They acted in bad faith, rendering the original insurance 1987 policy purchased meaningless to the insured and causing the Trust monetary harm.

The Trust seeks a correction of the lower court’s decision, monetary recovery, and as a matter of law — justice.

⁴³ App. p. 164 (Bankruptcy Complaint at ¶ 19.)

LEGAL ARGUMENT AND AUTHORITIES

In the appellate review for summary judgment the court must determine whether there is any issue of material fact and whether the lower court erred in applying the law.⁴⁴ Likewise, statutory construction is a question of law subject to de novo review of the appellate court.⁴⁵

A. Under U.S.C. §§ 547 and 550, when a bankruptcy complaint seeks to recover “the property, or the value of the property” in a preference action, it constitutes a threat, lien, or encumbrance on the subject property’s title.

The bankruptcy trustee sued the Trust because the one thing the debtor, LKE, transferred to the Trust was a property title. Although the Bankruptcy Complaint’s “wherefore” clause demands judgment of \$602,424.76, any relief granted through operation of the cited Bankruptcy Code provisions threatened the Trust’s property title. The bankruptcy’s use of 26 U.S.C. §§ 547 and 550 provided the legal framework to assert her authority to (1) avoid the transfer of property, and (2) recovery of the property, or the value of the property. Had the Bankruptcy Complaint been challenged and the outcome was still against the Trust, any final disposition of the court would have resulted in a threat, lien, or encumbrance on the Trust’s property.

Whether or not the bankruptcy trustee could have successfully avoided the transfer or recovered the value of the property are speculative defenses at best since Fidelity failed to defend the Trust under a policy purchased, but never delivered. The central issue on appeal is Fidelity’s duty to the Trust. Because LKE transferred only title and the available statutory

⁴⁴ *Zimmerman v. Safeco Ins. Co. of America*, 605 N.W.2d 727, 729 (Minn. 2000).

⁴⁵ *Fin Ag, Inc. v. Hufnagle, Inc.*, 720 N.W.2d 579, 584 (Minn. 2006).

authority of the bankruptcy trustee threatened the Trust's property title, Fidelity should have defended the Trust.

1. The Trust entered into a legitimate and favored tax deferred like-kind land transaction under 26 U.S.C. § 1031 transferring title of the sold and purchased properties to a qualified intermediary.

(i) A § 1031 safe harbor — a qualified intermediary.

The Trust disagrees with the lower court's characterization that it made a "very poor financial decision"⁴⁶ in entering a §1031 like-kind land transaction. The Trust did not make a "poor financial decision" any more than two parties selling and buying a home. If the realtor or realtor agency went bankrupt, and a bankruptcy trustee *implicates* that previous sale, did the parties make a poor financial decision? Hardly — but a legal action to undo the transfer of property or obtain its value, does threaten their respective property title. The Trust found itself in a similar situation.

A §1031 like-kind land transaction is not much more complex than a normal property transaction, but to correctly effect the transaction a party must follow with particularity Internal Revenue Service statutes and regulations governing like-kind exchanges. For instance, 26 U.S.C. §1031(a)(3) property received by a taxpayer — the Trust — shall not be treated as like-kind unless (a) the property is identified for purchase within 45 days after the date the taxpayer first transferred the property relinquished in the exchange, and (b) the taxpayer receives the new property prior to the earlier of (i) the midnight of the 180th day after the date on which the taxpayer transferred the property relinquished in the exchange, or (ii) the due date (including extensions) for the taxpayer-transferor's return for the year in

⁴⁶ App. p. 4.

which the transfer of the property relinquished in the exchange occurs.⁴⁷ The Trust met the requirements of subsection (i).

Furthermore, the protections afforded to the Trust for deferred tax consequences under an §1031 exchange are defeated if the Trust is in actual or constructive receipt of any funds used to acquire the sold (relinquished) or purchased (replacement) properties.⁴⁸ To avoid the IRS from challenging the exchange transaction on a constructive receipt or an agency theory, IRS regulations provide for safe-harbors.⁴⁹ One safe harbor is through the use of a qualified intermediary — LKE.⁵⁰

A qualified intermediary is a person who:

(A) Is not the taxpayer or disqualified person (as defined in paragraph (k) of this section), and

(B) *Enters into a written agreement with the taxpayer (the “exchange agreement”) and, as required by the exchange agreement, acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property, and transfers the replacement property to the taxpayer.*⁵¹

(ii). The Trust and LKE transfer property titles through a contract.

LKE entered into an agreement with the Trust under the legal regulatory safe harbor of a qualified intermediary. LKE acquired the relinquished property of the Trust, the Apple Valley property, transferred it and acquired the replacement property, the Jackson County property, and transferred it to the Trust. As the LKE agreement stated:

⁴⁷ See 26 C.F. R. §1.1031(k)-1(b)(3).

⁴⁸ See 26 C.F.R. §1.1031(k)-1(g)(4)(vi).

⁴⁹ There are four safe harbors found under 26 C.F.R. §§1.1031(k)-1(g)(2), 1(g)(3), 1(g)(4), and 1(g)(5).

⁵⁰ 26 C.F.R. §1.1031(k)-1(g)(4)

⁵¹ 26 C.F.R. §1.1031(k)-1(g)(4)(iii) (emphasis added).

[the Trust as the Exchangor] assigns all of his rights, title, and interest in and to that certain Purchase and Sale Agreement, and certain of his obligations thereunder to Intermediary.⁵²

The initial question is whether the parties intended to transfer legal title of the replacement property.⁵³ The LKE and Trust agreement is unambiguous. The Trust assigned “all rights, title, and interest” of the replacement property to LKE (as well as the relinquished property). And nothing more than legal title is required to effect a § 1031 like-kind land transaction.⁵⁴ The agreement of LKE and the Trust followed what must be done under federal regulations by the intermediary in order for LKE to be considered to have acquired and transferred the relinquished and replacement properties — LKE *acquired and transferred legal title to those properties.*

Furthermore, the agreement between the Trust and LKE is an executory contract giving, at the very least, LKE an equitable interest in the relinquished and replacement properties. In *Glasser v. Minnesota Federal Sav. & Loan Ass’n*, Minnesota courts have acknowledged that “[t]he purchaser in an executory contract for the sale of land is the equitable owner of the property.”⁵⁵ Thus, LKE had an interest in the property title, properly acquired through its agreement with the Trust, when LKE acquired and transferred the relinquished and the replacement properties to the Trust. The label of the interest is unimportant. Here, the Trust transferred both equitable and legal title to LKE.

⁵² App. p. 130.

⁵³ *In re Exchange Titles, Inc.*, 159 B.R. 303, 306 (Bankr. C.D. Cal. 1993) (The transfer of legal title is sufficient to effect § 1031 transaction but since parties did not transfer both legal and equitable rights to the property transferred the trustee is not a hypothetical bona fide purchaser under § 544(a)(3) and therefore is unable to avoid the equitable claim).

⁵⁴ *Id.*

⁵⁵ *Glasser v. Minnesota Federal Sav. & Loan Ass’n*, 389 N.W2d 763, 765 (Minn. App. 1986) citing *Hook v. Northwest Thresher Co.*, 91 Minn. 482, 98 N.W. 463 (1904).

Other courts recognized the functional effect of a § 1031 title transfer involving an intermediary. In *State v. Grimes*, the court described the purpose of the exchange:

[One] need not assume the benefits and burdens of ownership in property before exchanging it but may properly acquire title solely for the purpose of exchange and accept title and transfer it in exchange for other like property

.....⁵⁶

LKE's § 1031 agreement with the Trust successfully completed the property transaction and title transfer pursuant to federal regulations. And, there is no evidence in the record that the IRS challenged the like-kind land transaction.

Although it could be argued the acquired title as more “formal rather than real”⁵⁷ the facts of the LKE and Trust agreement assigning title cannot be dismissed. There is no evidence of a non-binding or fraudulent contract between the parties. The agreement legally bound both LKE and the Trust to adhere to IRS regulations to effect a § 1031 like-kind land transaction within the safe harbor requirements of a qualified intermediary. The legal reality embodies the assigned transfers of title to LKE of the relinquished and replacement properties involved in the § 1031 transaction. And all parties, Pulte, Fidelity — through Pulte as its agent, the Trust, and the Sellers were aware of the title transfers.⁵⁸

Although it could also be argued that the Trust did receive money from LKE, it did not receive any proceeds of the relinquished property (\$589,864.82). IRS regulations allow

⁵⁶ *State v. Grimes*, 46 P.3d 801, 805 (Wash. App. 2002) quoting *Aldemon v. C.I.R.*, 317 F.2d 790, 795 (9th Cir. 1963).

⁵⁷ *Id.*

⁵⁸ App. pp. 128-131; 132; 137-141.

for the receipt of money *after* the Trust received *all* of the identified replacement property.⁵⁹ Furthermore, money received did not defeat the §1031 safe harbor IRS regulations. For instance, the Bankruptcy Complaint identified one wire transfer that went from LKE directly to the Trust — \$2,424.76.”⁶⁰ The Trust received that money after it received all of the replacement property, after the successful completion of the § 1031 transaction. To have received any of the \$589,864.82 in proceeds of the original sale of the relinquished property would have defeated the deferred tax protections of the § 1031 like-kind land transaction.

What is of paramount importance is the contractual terms between LKE and the Trust and the effect of the § 1031 transaction. Pulte and Fidelity knew that under the agreement the Trust assigned the relinquished and replacement property titles to LKE. Young handled 30 to 50 § 1031 like-kind transactions herself⁶¹ and Fidelity is not only an insurance underwriter, but is a promoter of § 1031 exchanges.⁶² Issues regarding LKE business practices might have arisen in the defense of the Trust had Fidelity defended the Trust against the Bankruptcy Complaint, but any defensive strategy, issue, or outcome is now speculative. No one will ever know what could have or might have happened since Fidelity failed to defend the Trust under its own contractual title insurance agreement under the purchased 1987 policy.

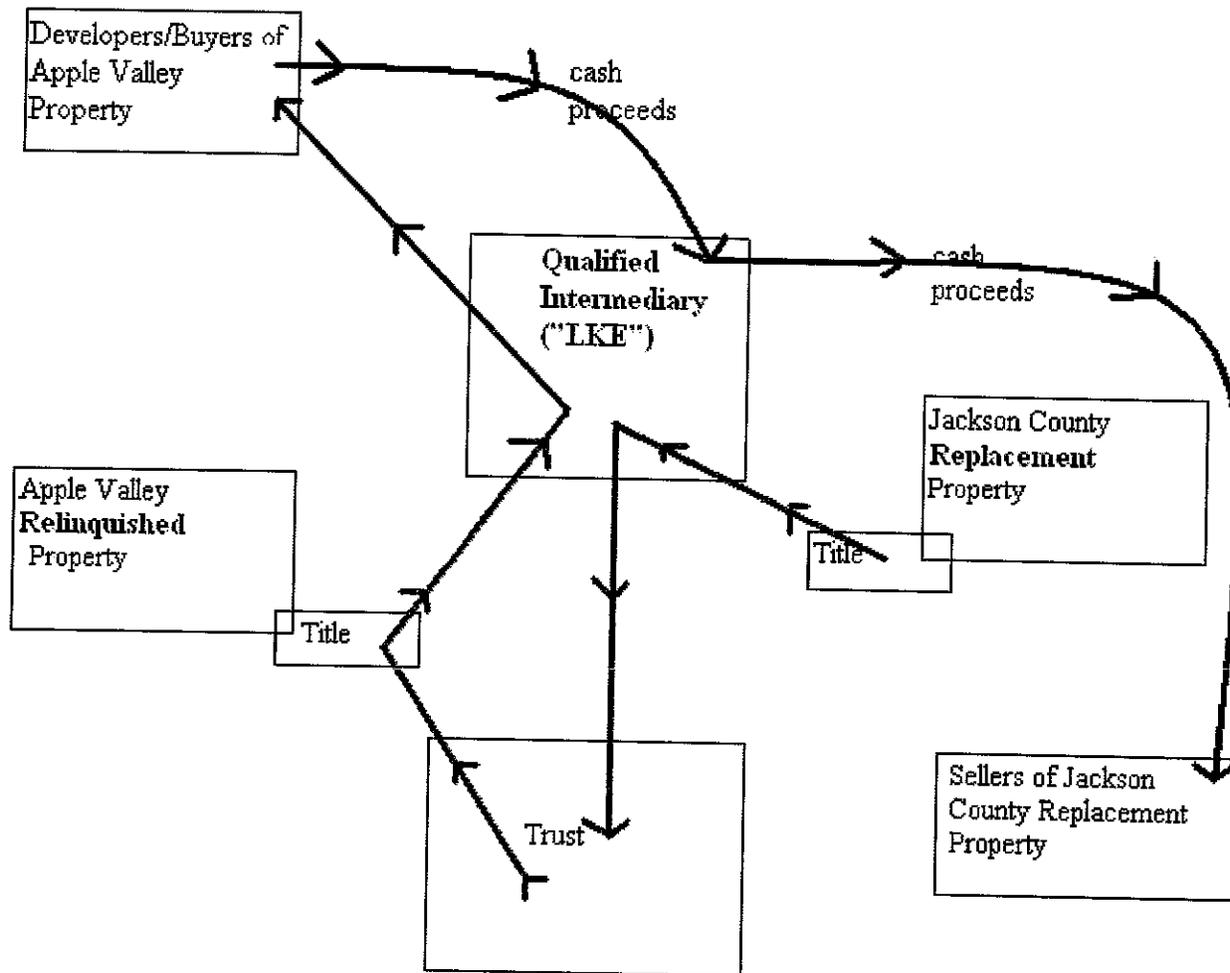
⁵⁹ 26 C.F.R. §1.1031(k)-1(g)(6); this would also include the balance between the original \$600,000 from the relinquished property sale (the Apple Valley property), and the final purchase price of the replacement Jackson County property, \$589,864.82.

⁶⁰ App. p. 166.

⁶¹ App. p. 28 (Young Depo. at p. 40).

⁶² App. pp. 195-204.

Chart — 26 U.S.C. § 1031 Like-Kind Land Exchange



2. Under 11 U.S.C. §§ 547 and 550 the bankruptcy trustee has the authority to avoid the Trust's property transfer with LKE, thus recover the "property, or the value of the property."

The Bankruptcy Complaint operated under 11 U.S.C. §§ 547 and 550⁶³ to recover for the benefit of the bankrupt estate, "the property or the value of the property transfer to the [Trust]."⁶⁴ Because the Trust assigned "all rights, title, and interest" of the replacement

⁶³ The Bankruptcy Complaint also cites 11 U.S.C. § 551 which provides that any *avoided transfer* is automatically preserved for the benefit of the estate. App. p. 164 (Bankruptcy Complaint at ¶ 19).

⁶⁴ App. at p. 164 (Bankruptcy Complaint at ¶ 20).

property for the purpose of a § 1031 like-kind exchange, the Trust, at the time of closing received only title to the replacement property from LKE.

The Bankruptcy Complaint, citing Sections 547 and 550, outlined the statutory weapons and scheme of the bankruptcy trustee to retrieve property for the benefit of the bankrupt estate: “[the] Trustee may recover, for the benefit of the estate, the property or the value of the property transfer to the Defendant [the Trust].”⁶⁵

First, 11 U.S.C. §§ 547 and 550 are distinct concepts and processes of avoidance and recovery. Therefore, the Bankruptcy Complaint essentially stated two causes of action against the Trust (1) to avoid the transfer and (2) recover from the transferee.⁶⁶

Second, avoidance under § 547 is a necessary precondition to recovery under § 550,⁶⁷ but does not imply avoidances as a sufficient condition for, or automatically triggers recovery.⁶⁸ “The [bankruptcy] trustee’s remedy of recovery is necessary only when the remedy of avoidance is inadequate.”⁶⁹

For instance, 11 U.S.C. § 547 governing preferences, allows the bankruptcy trustee to “avoid any transfer of an interest of the debtor [LKE] in property.”⁷⁰ In other words, the trustee may avoid the *entire transfer*, and if necessary, recover the property transferred or its

⁶⁵ App. p. 164 (Bankruptcy Complaint ¶ 20).

⁶⁶ *In re Mako, Inc.*, 127 B.R. 471, 474 (Bankr. E.D. Okl. 1991) (§ 550(a) is a secondary cause of action after a trustee has prevailed under the Bankruptcy Code’s avoidance sections, standing as a recovery statute and not as a primary avoidance basis for action, thus surviving only when coupled with the Code’s transfer avoidance sections).

⁶⁷ See *In re H & S Transp. Co.*, 939 F.2d 355, 359 (6th Cir. 1991) (“[A]ccording to the literal language of the statute there must be an avoidable transfer before there can be recovery by the trustee pursuant to section 550(a).”)

⁶⁸ *In re Mako, Inc.*, 127 B.R. at 474.

⁶⁹ *In re Burns*, 322 F.2d 421, 427 (6th Cir. 2003).

⁷⁰ 11 U.S.C. § 547(b).

value under § 550(a).⁷¹ The phrase “if necessary” is used because sometimes, as in the case of a security interest, avoidance is sufficient.⁷² Nevertheless, the bankruptcy court could order a “re-conveyance” of the transferred property to the bankruptcy trustee.⁷³

The second and more important purpose of avoiding transfers is to facilitate bankruptcy policy of equality of distribution among the debtor’s (LKE) creditors.⁷⁴ “Any creditor that received a greater payment than others of its class is required to disgorge so that all may share equally.”⁷⁵

The definition of *transfer* is as broad as possible:⁷⁶

- (A) the creation of a lien;
- (B) the retention of title as a security interest;
- (C) the foreclosure of a debtor’s equity of redemption;
- (D) each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing or parting with
 - (i) property; or
 - (ii) an interest in property.⁷⁷

Thus, “any interest in property is a transfer, including transfer of possession, custody or control even if there is no transfer of title, because possession, custody and control are

⁷¹ *In re DLC, Ltd.*, 295 B.R. 593, 601 (8th Cir BAP 2003).

⁷² *Id.* at 601, n.7.

⁷³ *In re Hill*, 342 B.R. 183, 205 (Bankr. D. N.J. 2006).

⁷⁴ Lawrence P. King, Alan N. Resnick, Henry J. Sommer, *Collier on Bankruptcy*, vol. 5, § 547.01 (5th ed., Matthew Bender & Company, Inc. 2006).

⁷⁵ *Id.*

⁷⁶ S Rep.No. 989, 95th Cong., 2d Sess. 27 (1978).

⁷⁷ 11 U.S.C. § 101(54).

interests in property.”⁷⁸ The effect of the § 1031 like-kind land transaction gave LKE title to the Trust’s replacement property and transferred that title to the Trust. The Trust did not and could not receive the value of the property in cash or it would have violated § 1031 IRS exchange regulations. Regardless, the Bankruptcy Complaint targeted for avoidance the replacement Jackson County property transaction of the Trust.

It could be argued however, that because the \$600,000 was in the possession of LKE, the cash was an “interest of the debtor in property.”⁷⁹ However, the argument is not persuasive. Although the Bankruptcy Code does not define the term “interest of the debtor in property,” the United States Supreme Court found it to mean “that property that would have been part of the estate had it not been transferred before the commencement of bankruptcy proceedings.”⁸⁰ Thus, a trustee “may only seek those legal or equitable interests that the debtor [LKE] would have held at the time of the petition but for [LKE’s] transfer of those interests.”⁸¹

To determine what constitutes a legal or equitable interest, Minnesota state law is controlling.⁸²

The Minnesota Supreme Court in *In re Butler* adopted a Fifth Circuit Court of Appeals definition of “transfer” in determining whether a particular event qualified as a “transfer” under the Minnesota Fraudulent Transfer Act.⁸³ The Court declared its acceptance of the Fifth Circuit definition that “the comprehensive character of [transfer] leads us to conclude

⁷⁸ *Collier on Bankruptcy*, vol. 5, § 547.03[1].

⁷⁹ 11 U.S.C. § 547(b).

⁸⁰ *Begier v. IRS*, 496 U.S. 53, 54 (1990).

⁸¹ *In re Kelton Motors, Inc.*, 97 F.3d 22, 25 (2nd Cir. 1996).

⁸² *Barnill v. Johnson*, 503 U.S. 393, 398 (1992); *In re Smith*, 966 F.2d 1527, 1530 (7th Cir. 1992).

⁸³ *In re Butler*, 552 N.W.2d 226 (Minn. 1996); Minn. Stat. §§ 513.41-513.51.

that the transfer of title to the real property of the debtor ... constitutes a 'transfer' by the debtor in possession⁸⁴ The Minnesota Supreme Court in agreeing with the Circuit's definition also stated that "every mode" of disposing of or parting with an asset is comprehensive⁸⁵ Minnesota courts have not modified this definition.

LKE did not transfer money to the Trust. LKE transferred *title* of the replacement property to the Trust — the § 1031 agreement and transaction being a mode of disposing or parting with an asset, the asset being the property.

Thus, the Trust's assignment of title of the replacement Jackson County property to LKE to effect the § 1031 like-kind transaction, constituted a transfer of title to real property of the bankruptcy debtor — LKE— to the Trust at the time of closing. And the date of the closing, wherein title was transferred, was also within the preference period of the debtor's bankruptcy petition. Therefore, because the bankruptcy trustee's authority under 11 U.S.C. § 547(b) included the power to "avoid any transfer of an interest of the debtor in property ... (4) on or within 90 days before the date of the filing of the petition" the Bankruptcy Complaint threatened the title of the Trust's Jackson County property.

⁸⁴ *Durrett v. Washington Nat'l Ins. Co.*, 621 F.2d 201, 203-204 (5th Cir. 1980).

⁸⁵ *In re Butler*, 522 N.W.2d at 234.

3. The bankruptcy trustee, if the court so orders, may recover the property transferred or its value thus implicating the Trust's Jackson County replacement property and clouding its title.

(i). The lower court did not fully appreciate the bankruptcy court's discretion to recover property or its value and thus the threat to property title.

After avoidance of a transfer, 11 U.S.C. § 550 permits the bankruptcy trustee to recover property transferred or the value of the property transferred with the assistance of the court:

[T]he trustee may recover, for the benefit of the estate, the property transferred, or if the court so orders, the value of such property,⁸⁶

In short, "recovery is a bankruptcy remedy for avoidance [per § 547] which makes transferees of the affected property, and the people for whose benefit the transfer was made, personally accountable to the estate for the return of the property or for its value."⁸⁷

The court does not have discretion to order that neither the property nor its value be recovered⁸⁸ since the intent of Section 550 is to restore the bankrupt estate to the financial condition it would have enjoyed if the transfer of the property had not occurred.⁸⁹

In addition, the bankruptcy trustee is entitled to only a single satisfaction under Section 550(a) — the property transferred, or the value of the property.⁹⁰ Although the Bankruptcy Code does not give guidelines to aid the court to determine when to permit the recovery of the value of the property rather than the property itself, factors considered in making the decision include:

⁸⁶ 11 U.S.C. § 550(a).

⁸⁷ *In re Burns*, 322 F.2d at 428.

⁸⁸ *In re Willaert*, 944 F.2d 463, 464 (8th Cir. 1991).

⁸⁹ *In re Acequia, Inc.*, 34 F.2d 800, 812 (9th Cir. 1994).

⁹⁰ 11 U.S.C. § 550(d); *In re Jameson's Foods, Inc.*, 35 B.R. 433, 440 (Bankr. D. S.D. 1983).

- whether the property is recoverable;
- whether the property has diminished in value;
- whether there is conflicting evidence as to the value of the property;
- and whether the value of the property is readily determinable and a monetary award would be a savings to the estate.⁹¹

Thus, where the subject property itself is unrecoverable, the court will generally allow the trustee to recover the value of the property.⁹² However, courts “favor a return of the property itself if at all possible so as to avoid speculation over its value.”⁹³ And courts will award the return of the property when the record fails to establish the value of the property transferred.⁹⁴ But, some courts will award the return of property where the record does not establish the value of the property transferred.⁹⁵

In *In re Vedaa*, the bankruptcy trustee sought recovery of the property transferred or the value of property from the transferees of real estate from the debtor. When the defendant transferees offered to return the property, the trustee requested the court award a monetary judgment instead.⁹⁶ But because courts favor return of the property itself, the court directed the trustee to recover the subject real estate.⁹⁷

On the other hand, if the “preferentially transferred property cannot be returned to the bankruptcy estate, the court must order its value returned to the bankruptcy estate.”

⁹¹ See *In re Centennial Textiles, Inc.* 39 B.R. 165, 177 (Bankr. S.D.N.Y. 1998).

⁹² *In re Vedaa*, 49 B.R. 409, 411 (Bankr. N.D. 1985).

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ See *In re Handsco Distributing, Inc.*, 32 B.R. 358 (Bankr. S.D. Ohio 1983).

⁹⁶ *In re Vedaa*, 49 B.R. at 411.

⁹⁷ *Id.*

When value of the property is recovered, rather than the property itself, “value” refers to fair market value.⁹⁸ As the Eighth Circuit has opined, because “the purpose and thrust for this section is to restore the debtor’s financial condition to the state it would have been had the transfer not occurred,” a trustee is entitled to recover the fair market value at the time of transfer.⁹⁹ Furthermore, if there is a depreciation of the market value of the property due to market fluctuations after the transfer, the court may order restitution of the property’s value at the time of the transfer rather than the property.¹⁰⁰

Nevertheless, the LKE’s bankruptcy and the powers of the bankruptcy trustee exposed the Trust’s replacement property to recovery. Subsections 550(a)(1) and (2) permit the trustee to recover from the initial transferee¹⁰¹ — the Trust — “or” the entity for whose benefit the transfer was made¹⁰² — again, the Trust — the property itself or the value of the property.

“Or” is not exclusive.¹⁰³ A trustee could recover from any combination of entities subject to the limitation of a single satisfaction (11 U.S.C. § 550(e)). In addition, the trustee in theory, could recover from both the initial transferee of the debtor and subsequent transferees, possibly for instance the sellers of the replacement property, however, the trustee’s right to do so is limited by §§ 550(b), (c), (d), and (e). Whether any of the

⁹⁸ See *In re Vann*, 26 B.R.148 (Bankr. S.D. Ohio 1983) (“the term ‘value’ connotes market value”)

⁹⁹ *In re Da-Sota Elevator Co.*, 939 F.2d 654, 655 (8th Cir. 1991).

¹⁰⁰ *Id.*

¹⁰¹ See *In re C.F. Foods, L.P.*, 265 B.R. 71 (Bankr. E.D. Pa. 2001) (Initial transferee is defined as one who has dominion over money or other asset having the right to use it for one’s own purposes).

¹⁰² See *In re Carrozzella & Richardson*, 302 B.R. 415 (Bankr. D.C. Conn. 2003).

¹⁰³ 11 U.S.C. § 102(5).

limitations applied to the Trust as defenses to recovery are moot since Fidelity failed to defend the Trust in the bankruptcy litigation.

Nevertheless, the lower court characterized the Bankruptcy Complaint's relief in the amount of \$602,424.76 as merely a "monetary judgment" demand against the Trust. However, the relief identified had to be through either or both causes of action under 11 U.S.C. §§ 547 (avoidance) and 550 (recovery).

As the Bankruptcy Code allows— once the transfer is avoided (§ 547) — the remedy of recovery under § 550 is available, and it is within the *discretion of the court* whether the property itself, or the value of the property, shall be the relief. Either decision of the court is a threat, lien, or encumbrance to the Trust's property title. The Trust loses the property if returned and if the value is entered as a judgment, the bankruptcy judgment is a lien on the property thus clouding title. Under Minn. Stat. § 548.09, subd. 1, a successful judgment against the Trust, when docketed becomes a lien for the unpaid judgment amount on "all real property in the county then or thereafter owned by the judgment debtor."¹⁰⁴

(ii). The lower court did not fully appreciate the significance of LKE's and the Trust's contract assigning all title and interest in the Jackson County property to LKE.

The lower court did not discuss the original contract between the Trust and LKE and thus did not fully appreciate its significance. Without this analysis, it maybe understandable how the lower court reached its conclusion, however, a further examination of the Trust and LKE agreement undermines the court's conclusion that the Bankruptcy Complaint sought

¹⁰⁴ Minn. Stat. § 548.09, subd 1 (2004); *Hook v. Northwest Thresher Co.*, 91 Minn. 482, 98 N.W 463 (1904).

solely a cash judgment. For instance, it could be argued that the Bankruptcy Complaint relief of \$602,424.76 reflected only the proceeds in LKE's possession prior to the transfer of the replacement property's title. However, the bankruptcy trustee could not have ignored or rejected the agreement between LKE and the Trust to assign and transfer title of the replacement property.¹⁰⁵

For instance, in cases where the bankruptcy estate (trustee) succeeded to the debtor's position under an existing contract, if the defendant to the bankruptcy action had fully performed his duties under the contract, it remained for the bankruptcy trustee to perform the debtor's duties. The contract in this instance is not executory. In *In re Nation-Wide*, the defendant had performed all of his duties under an existing pre-bankruptcy petition contract.¹⁰⁶ Seeking specific performance, the debtor argued that because he had performed all duties imposed in existing contracts, the bankruptcy trustee had a duty to convey the property title to the defendant.¹⁰⁷ The court agreed.

The court ordered the bankruptcy trustee to tender a deed to the real property to the defendant. However, the court determined the bankruptcy trustee had met all requirements to avoid the preferential transfer under § 547 and using the court's discretionary authority,

¹⁰⁵ At the time of the filing of the Bankruptcy Complaint, the bankruptcy trustee apparently was not fully aware of the terms of the LKE and the Trust § 1031 Agreement, specifically regarding the Trust's assignment of all rights and interests in title to LKE. App. p. 162 (Bankruptcy Complaint at ¶ 7), *compare with* App. p. 130.

¹⁰⁶ *In re Nation-Wide Exchange Services, Inc.*, 291 B.R. 131, 153 (Bankr. D. Minn. 2003).

¹⁰⁷ *Id.*

allowed the recovery of the amount of the value of the property under § 550 and entered judgment accordingly.¹⁰⁸

The bankruptcy trustee is bound by the limitations of the property of the debtor (LKE) that passed into the bankruptcy estate with all the limitations on it pursuant to an existing contract and applicable contract law¹⁰⁹ As the U.S. Bankruptcy Court of the District of Minnesota opined in *In re Nation-Wide Exchange Services, Inc.*, “[t]he general statutory grant to trustees, of administrative power over property of the estate, does not override the characteristics of that property under nonbankruptcy law, or supplant any limitations on its disposition that applied to it pre-petition.”¹¹⁰

At the time of the bankruptcy petition, the LKE and the Trust fully performed all duties under the agreement and LKE transferred the replacement property title to the Trust. Thus, since the transfer likely occurred during the preferential period and avoidable under § 547, had the matter been fully litigated, the court could have used its discretionary authority to recover either the Trust’s replacement property itself or the value of the property under § 550. Regardless of the possible final outcome, the Trust’s title to its replacement property came into jeopardy with the filing of the Bankruptcy Complaint.¹¹¹ Faced with the daunting

¹⁰⁸ *In re Nation-Wide*, 291 N.W.2d at 153.

¹⁰⁹ *In re Schauer*, 835 F.2d 1222, 1225 (8th Cir. 1987).

¹¹⁰ *In re Nation-Wide Exchange Services, Inc.*, 291 B.R. at 153 citing *In re Schauer*, 835 F.2d 1222, 1225 (8th Cir. 1987).

¹¹¹ Any issue regarding whether or not duties under the exchange agreement between LKE and the Trust were fully performed are genuine material issues of fact.

possibilities under the Bankruptcy Code and no help from Fidelity, the Trust had no alternative but to settle the bankruptcy litigation for \$102,412.20.¹¹²

B. The Bankruptcy Complaint's demand for avoidance and recovery of the Trust's property is a threat, lien, or encumbrance on the Trust's property title, events that trigger the duty to defend the insured.

In the appellate review of summary judgment the court must determine whether there is any issue of material fact and whether the lower court erred in applying the law.¹¹³ Likewise, appellate review of a contract and its legal effect, where no ambiguity exists, is a question of law.¹¹⁴ Determining whether the terms are ambiguous is a matter for the court without deference to the lower court's decision.¹¹⁵ Finally, where material facts are not in dispute and the sole question is a question of insurance policy interpretation, the court's review is *de novo*.¹¹⁶

1. The Trust purchased a 1987 title insurance policy that insured against "threats, lien, or encumbrances" to property title.

The Trust purchased title insurance for the § 1031 like-kind replacement property. Pulte offered a 1987 ALTA policy and the Trust accepted the offer. The terms of the 1987 ALTA policy covered the subsequent allegations of the Bankruptcy Complaint involving LKE and the replacement property. Because the allegations and possible judgment threatened the Trust's property title, Fidelity as the insurer, had a duty to defend the Trust.

¹¹² App. pp. 167-70.

¹¹³ *Zimmerman*, 605 N.W.2d at 729.

¹¹⁴ *Blackburn, Nickels & Smith, Inc.*, 366 N.W.2d 640, 643 (Minn. App. 1985).

¹¹⁵ *Id.* If the court determines the need to rely upon extrinsic evidence and the evidence is conclusive, the question becomes a question of fact for a jury.

¹¹⁶ *Zimmerman*, 605 N.W.2d at 729; *see also, State Farm Ins. Cos. v. Seefeld*, 481 N.W.2d 62,62 (Minn. 1992).

- (i) **The Trust purchased a 1987 ALTA policy through a contract with Pulte, an agent of Fidelity.**

Pulte offered title insurance to the Trust¹¹⁷ and the Trust purchased a 1987 ALTA title insurance policy through an offered commitment.¹¹⁸ The act is an insurance transaction under Minnesota statutory law, Pulte having acted on behalf of Fidelity.¹¹⁹ The commitment identified the policy as an “ALTA Residential Owner’s Policy – 1987,”¹²⁰ for the value of the Jackson County § 1031 replacement property in the amount of \$589,864.82.¹²¹

Although redundant in the use of terms, Fidelity’s Vice-President and Regional Counsel Paul Cozzi defined the commitment as “a commitment to issue a policy in a manner as set forth in the commitment.”¹²² It is a contract. It could also be referred to as an insurance binder. However it is labeled, as Cozzi stated, because the commitment identified the 1987 ALTA title insurance policy, Fidelity would have issued that particular policy to the Trust.¹²³

If the commitment is labeled as a binder, it is an insurance policy. Minnesota statutory law is inclusive of “binders” within the definition of an “insurance policy:”

“Insurance policy” or “policy” means the written instrument in which are set forth the terms of any certificate of insurance, binder of coverage, or contract of insurance”¹²⁴

¹¹⁷ App. p. 136

¹¹⁸ App. pp. 137-141

¹¹⁹ Minn. Stat. § 60A.951, subd.4c. “Insurance transaction means a transaction by, between, or among (1) an insurer or a person who acts on behalf of an insurer;” Pulte acted on behalf of the insurer Fidelity in offering the 1987 policy to the Trust.

¹²⁰ App. pp. 137-141.

¹²¹ *Id.*

¹²² App. p. 99 (Cozzi Depo. at p. 22).

¹²³ App. p. 98 (Cozzi Depo. at p. 18-19).

¹²⁴ Minn. Stat. § 60A.951, subd. 4a.

Likewise, the commitment labeled as a contract, is a contract of insurance.

The commitment is unambiguous as a contract and as a binder of insurance. It identifies the purchasers; it identifies the amount of the purchase price of the policy; it identifies the value of the property; it identifies the coverage and limitations of coverage; and it identifies the policy purchased. Furthermore, there is no evidence in the record that Pulte or the Trust engaged in any subsequent modification of their contract to suggest a change in coverage or a change in policy.¹²⁵

Thus, at the closing of the § 1031 like-kind land transaction of the Jackson County replacement property, the Trust had title insurance, an “ALTA Residential Owner’s Policy – 1987” purchased for \$1,032.50,¹²⁶ for the identified property,¹²⁷ for the property value of \$589,864.82,¹²⁸ with exceptions to coverage “unless they are taken care of to our [the insurer’s] satisfaction”¹²⁹ The Trust met all obligations required of the insurer. There is no evidence in the record to suggest the Trust did not meet the requirements of the insurer “to [its] satisfaction” regarding the “exceptions” to coverage. The Pulte commitment for insurance as a contract and binder is not ambiguous. The Trust bought a 1987 ALTA policy.

¹²⁵ *Yartiz v. Dahl*, 367 N.W.2d 616, 617 (Minn. 1985).

¹²⁶ Pulte Doc. No. 1.

¹²⁷ Pulte Doc. No. 15.

¹²⁸ Pulte Doc. No. 11.

¹²⁹ Pulte Doc. No.13.

(ii) The 1987 ALTA policy covered the property transaction.

When interpreting an insurance policy, appellate courts apply general principles of contract interpretation.¹³⁰ Thus, if an insurance contract is unambiguous, the court will give the language its “usual meaning”¹³¹ However, any ambiguity regarding coverage will be construed in favor of the insured.¹³² If a word or phrase of an insurance policy is reasonably subject to more than one interpretation, it is considered ambiguous.¹³³ In addition, exclusions in coverage are narrowly construed against the insurer.¹³⁴

The 1987 ALTA title insurance policy specifically covered:

- (14). Other defects, liens, or encumbrances¹³⁵

The policy’s language regarding exclusions included:

3. Defects, liens, encumbrances, adverse claims or other matters:

- (a) created, suffered, assumed or agreed to by the Insured Claimant. ...¹³⁶

The 1987 ALTA policy does not exclude coverage for § 1031 exchanges nor for claims arising from federal bankruptcy laws.¹³⁷

¹³⁰ *Reinsurance Ass’n of Minnesota v. Timmer*, 641 N.W.2d 302, 307 (Minn. App. 2002).

¹³¹ *Id.* citing *Am. Family Ins. Co. v. Walser*, 628 N.W.2d 605, 609 (Minn. 2001).

¹³² *Am. Family Ins. Co. v. Walser*, 628 N.W.2d 605, 609 (Minn. 2001).

¹³³ *Reinsurance Ass’n of Minn. v. Hanks*, 539 N.W.2d 793, 796 (Minn. 1995).

¹³⁴ *Atwater Creamery Co. v. Western National Mutual Ins. Co.*, 366 N.W.2d 271, 276 (Minn. 1985); on the other hand, if the insurer demonstrates the applicability of an exclusion, then the insured bears the burden of proving an exception to the exclusion. *SCSC Corp. v. Allied Mut. Ins. Co.*, 536 N.W.2d 305, 314 (Minn. 1995). If issues are not resolved as a matter of law because of the lack of evidence in the record, it is a material fact for the trier of fact.

¹³⁵ App. p. 144.

¹³⁶ App. p. 148.

¹³⁷ App. pp. 142 - 150.

The Bankruptcy Complaint against the Trust asserted certain factual allegations regarding how the debtor, LKE, transferred \$602,424.76 for the benefit of the Trust, for or on account of an antecedent debt, made through wire transfers, the amounts being transferred while insolvent¹³⁸ and:

19. The transfer, if not avoided, will enable the Defendant [Trust] to recover more than it would receive a creditor if (a) the transfer had not been made, and (b) the Defendant received payment of the debt to the extent provided by the provisions of the Bankruptcy Code.

20. Pursuant to 11 U.S.C. §§ 550 and 551, the Trustee may recover, for the benefit of the estate [the bankrupt LKE], the property or the value of the property transfer[red] to the Defendant.¹³⁹

The Bankruptcy Complaint mis-described the § 1031 like-kind land transaction, a transaction Fidelity and Pulte knew about before the filing of the Complaint.¹⁴⁰ In addition, the allegations do not identify the agreement between LKE and the Trust regarding the assignment of title to LKE to effect the § 1031 like-kind land transaction, the agreement of which Fidelity and Pulte knew about before the filing of the Complaint.¹⁴¹

More importantly, for the purpose of determining whether the Bankruptcy Complaint's allegations fall arguably within the 1987 ALTA title policy coverage provisions,

¹³⁸ App. p. 166; 163-164 (Bankruptcy Complaint, ¶¶ 15, 16, 17, and 18).

¹³⁹ App. p. 166; 164 (Bankruptcy Complaint at ¶¶ 19 and 20).

¹⁴⁰ Pulte as an agent of Fidelity, committed it to a 1987 ALTA title insurance policy that should have been issued to the Trust. Cozzi testified that under the commitment entered into between Pulte and the Trust, Fidelity was obligated to deliver it. But Fidelity failed to deliver the purchased policy before the filing of the Bankruptcy Complaint. Any issue regarding Fidelity's knowledge of the § 1031 transaction not within the record is a question of material fact.

¹⁴¹ The Bankruptcy Complaint is dated November 8, 2000. The Trust's counsel tendered a claim with Fidelity and communicated several times in writing with Fidelity from October 13, 2000 through October 18, 2001 (the Trust's settlement) regarding the facts and circumstances of the Complaint and § 1031 like-kind land transaction.

although paragraphs 19 and 20 of the Complaint fall below the caption “Claim for Relief” no where in the Complaint did the bankruptcy trustee label a certain paragraph or paragraphs as “causes of action.” However, she did reference the Bankruptcy Code in paragraph 19 for the allegation of “avoidance” (a reference to § 547 of the Bankruptcy Code) and specifically cited § 550 in paragraph 20, referencing specifically the ability of the bankruptcy trustee to recover the property itself or the property’s value.¹⁴² Under the Bankruptcy Code, avoidance under § 547 and recovery under § 550 are separate causes of action. And both causes of action threatened the title of the Jackson County replacement property of the successful § 1031 like-kind land transaction. Nevertheless, what do the claims and allegations of the Bankruptcy Complaint mean within the scope of Pulte’s and Fidelity’s knowledge of the original § 1031 like-kind land transaction?

- First, if the bankruptcy trustee is able to avoid the § 1031 like-kind land transactions, property title is threatened.
- Second, if the bankruptcy trustee is able to recover the property itself, the Trust will lose the use of the property, threatening title.
- Third, if the bankruptcy trustee is able to recover the value of the property, the judgment lien on the property is a threat, lien, or encumbrance of the title. The title becomes clouded and unmarketable.
- Fourth, there is no provision in the 1987 ALTA policy purchased that excluded a § 1031 like-kind land transaction.
- Fifth, there is no provision in the 1987 ALTA policy purchased that excluded bankruptcy actions that may threaten property title under provisions of the Bankruptcy Code.

¹⁴² 11 U.S.C. § 547 is also cited in heading of the Complaint. If anything, the Bankruptcy Complaint is not artfully written, however, sufficient as a notice pleading and to determine Fidelity’s obligations to the Trust under the purchased 1987 ALTA policy.

The allegations of the Bankruptcy Complaint fall within the terms of the Trust's 1987 purchased policy. LKE transferred title to the Trust. It did not transfer cash to the Trust, otherwise it would have violated IRS regulations and defeated the § 1031 like-kind land transaction. There is no evidence in the record or allegations from Fidelity or Pulte that the Trust violated § 1031 like-kind land transaction regulations. But, Pulte and Fidelity knew of the agreement between LKE and the Trust to effect the § 1031 like-kind land transaction.¹⁴³

Thus the only "property" the bankruptcy trustee could seek as a remedy under the Bankruptcy Complaint included the property transferred, that is, the Jackson County replacement property, or the value of that property. Thus, the avoidance claim asserted in paragraph 19 of the Bankruptcy Complaint sought the avoidance of the transfer of the Jackson County property.

The cause of action within paragraph 20 of the Bankruptcy Complaint sought recovery under § 550 of the Bankruptcy Code, allowed either for the recovery of the property itself or the value of the property — at the discretion of the court — the transferred property's actual value being \$589,864.82. The bankruptcy trustee alleged a value of \$602, 426.76 as a judgment, but had the matter been litigated, the Trust had sufficient defenses to challenge the allegations of the bankruptcy trustee. However, whatever the defenses available to the Trust, it is futile to explore since the issue is moot because Fidelity did not defend the Trust.

¹⁴³ App. p. 29 (Young Depo. at p. 42); App. pp. 170-182.

Nevertheless, the causes of action alleged through the Bankruptcy Complaint for avoidance and recovery threatened the title of the Jackson County property. Avoidance of the transfer of property title would have opened the way for the recovery of the property or the value of the property (the property value becoming a judgment). Either result is a threat, lien, or encumbrance on the title.

Furthermore, the absence of an explicit exclusion of a §1031 like-kind land transaction or actions involving federal bankruptcy laws, gave the Trust a reasonable expectation of coverage. The doctrine of “reasonable expectations” protects the “objectively reasonable expectations” of insureds “even though painstaking study of the policy provisions would have negated those expectations”¹⁴⁴ The Trust purchased title insurance with the expectation of coverage of all events associated with the § 1031 transaction,¹⁴⁵ a transaction Pulte was intimately familiar with.¹⁴⁶

A painstaking study of the 1987 ALTA title insurance policy does not reveal policy provisions negating the expectations of the Trust of coverage for events associated with or arising from the § 1031 transaction or the bankruptcy action. It is reasonable therefore, to expect that because there is no identified exclusion of an event (bankruptcy) or transaction (§ 1031 exchange), it is otherwise, and expected to be covered by the policy.

¹⁴⁴ *Atwater Creamery v. Western Nat'l Mut. Ins.*, 366 N.W.2d 271, 277 (Minn. 1985)(quoting Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 Harv. L. Rev. 961, 967 (1970)).

¹⁴⁵ App. p.73 (Recthzigel Depo. at pp 85-86).

¹⁴⁶ App. pp. 28-29 (Young Depo. at pp. 28-29).

The lower court, in the interpretation of the 1987 ALTA policy, fundamentally changed the meaning of the 1987 policy. The lower court declared that for Fidelity to have a duty to defend the Trust, the policy had to explicitly state coverage for a § 1031 transaction and claims arising from federal bankruptcy actions. Yet, the policy did not exclude coverage, unlike Fidelity's 1992 ALTA policy that specifically identifies what is excluded. But the court cannot have it both ways — it is the same as having no standard of policy interpretation for an insured's coverage. The lower court's opinion nevertheless defeats the doctrine of reasonable expectations of the Trust regarding the 1987 ALTA policy provisions as purchased.

It might be argued that the Trust's agreement with LKE was a type of risk high business transaction, not otherwise covered by a title insurance policy. Pulte participated in 30 to 50 § 1031 transactions so if the practice is so risky, then why would Pulte actively participate in such business practices and offer title insurance? The evidence is to the contrary; a § 1031 like-kind transaction is not a risky real estate transaction, but an accepted federally regulated practice to defer tax consequences of land transactions. The agreement between LKE and the Trust assigned all interests of the Jackson County replacement property to the qualified intermediary — LKE — as an IRS safe harbor to transfer the property.

Pulte offered and the Trust accepted title insurance, an exclusion under the 1987 ALTA purchased policy being "claims or other matters: created, suffered, assumed or agreed

to by the Insured Claimant.” The Trust did not create the circumstances surrounding LKE’s bankruptcy.

Although Minnesota courts have not directly interpreted the policy phrase, “created, suffered and assumed” other courts have. In *America Sav. & Loan Ass’n v. Lawyers Title Ins. Corp.*,¹⁴⁷ the Sixth Circuit Court of Appeals determined “created, suffered and assumed” implied deliberate, rather than negligent actions.¹⁴⁸ In other words, “created” means deliberate, rather than an inadvertent act; “suffered” means to “permit, which implies the power to prohibit or prevent the claim from arising;”¹⁴⁹ and “assumes” means “actual knowledge of a title defect.”¹⁵⁰

LKE became an insolvent entity. The Trust did not create an act contributing to LKE’s bankruptcy despite the § 1031 transaction occurring within the 90 day preference period. The Trust did not have the power to prohibit or prevent the bankruptcy or the bankruptcy litigation, and it did not have any knowledge that the § 1031 transaction would be targeted in the Bankruptcy Complaint creating the threat to the Trust’s Jackson County replacement property title.

Since the Minnesota Supreme Court has found that the purpose of insurance is to protect against results not intended or expected¹⁵¹ there is no evidence within the record to support any Fidelity or Pulte assertion that the Trust engaged in an intentional or reckless act

¹⁴⁷ *America Sav. & Loan Ass’n v. Lawyers Title Ins. Corp.*, 793 F.2d 780, 784 (6th Cir. 1986).

¹⁴⁸ *Id.*

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*

¹⁵¹ *Franklin v. Western Nat’l Mut. Ins. Co.*, 574 N.W.2d 405, 408 (Minn. 1998).

regarding the § 1031 transaction. In *Franklin v. Western Nat. Mut. Ins. Co.*, the court stated that:

[An] insurer is in the business of distributing losses due to such property damage among a large number of policyholders. It is able to properly set premiums and supply coverage only if those losses are uncertain from the standpoint of any single policyholder. If the single insured is allowed through intentional or reckless acts to consciously control the risks covered by the policy, a central concept of insurance is violated.¹⁵²

The Trust did not engage in an intentional or reckless act that resulted in a claim under the 1987 ALTA policy. The Bankruptcy Complaint victimized the Trust, but the 1987 ALTA policy covered the § 1031 like-kind land transaction and the Trust's reasonable expectations included a defense from Fidelity to the Complaint's causes of action.

(iii). Fidelity had a duty to defend the Trust.

Under Minnesota law, the insurer assumes two duties to the insured: the duty to defend and the duty to indemnify.¹⁵³ The duty to defend is much broader than the duty to indemnify.¹⁵⁴ That duty to defend the insured on a claim arises when any part of a claim against the insured arguably falls within the scope of the policy.¹⁵⁵ As the Minnesota Supreme Court has stated: "an insurer who wishes to escape that duty [to defend] has the burden of showing that all parts of the cause of action fall clearly outside the scope of

¹⁵² *Franklin v. Western Nat'l Mut. Ins. Co.*, 574 N.W.2d at 408.

¹⁵³ *Reinsurance Assoc. of Minn.*, 641 N.W.2d at 307.

¹⁵⁴ *Meadowbrook, Inc. v. Tower Ins. Co.*, 559 N.W.2d 411, 415 (Minn. 1997)

¹⁵⁵ *Reinsurance Assoc.*, 641 N.W.2d at 307.

coverage.”¹⁵⁶ Thus, “unless the pleadings and facts clearly establish that the claim falls outside the policy terms, the duty to defend arises”¹⁵⁷

It is further appropriate for the court to consider the applicability of the duty to defend as of the time the insured, the Trust, tendered the defense to the insurer, Fidelity.¹⁵⁸ Generally, the duty to defend is determined by comparing the allegations of the complaint to the language of the insurance policy, but courts may look beyond the complaint and to extrinsic facts to establish the existence or nonexistence of that duty.¹⁵⁹ However, “where the insurer has no knowledge to the contrary, it may make an initial determination of whether or not it is obligated to defend from the facts alleged in the complaint against its insured.”¹⁶⁰

Whether based solely on the allegations of the Bankruptcy Complaint, or combined with the extrinsic facts provided to Fidelity when the Trust tendered its claim, Fidelity owed a duty to defend the Trust in the LKE bankruptcy action. And the decision of the lower court agreed in part: “[i]f the only question was what the bankruptcy trustee *could have asked for* in the Preference Action (such as title to the Replacement Property), then the Defendants might have had a duty to defend.”¹⁶¹ But because the lower court misinterpreted Bankruptcy Code provisions and the effect of the bankruptcy trustee’s authority to the Trust’s property title the court reached an adverse conclusion against the Trust.

¹⁵⁶ *Josten’s, Inc. v. Mission Ins. Co.*, 387 N.W.2d 161, 165-66 (Minn. 1986).

¹⁵⁷ *John Deere Ins. Co. v. Shamrock Indus., Inc.*, 929 F.2d 413, 418 (8th Cir. 1991).

¹⁵⁸ *Josten’s, Inc.*, 387 N.W.2d at 167.

¹⁵⁹ *Tschimperle v. Aetna Cas. & Sur. Co.*, 529 N.W.2d 421, 424 (Minn. App. 1995).

¹⁶⁰ *Garvis v. Employers Mut. Cas. Co.*, 497 N.W.2d 254, 258 (Minn. 1993).

¹⁶¹ App. p. 5.

First, the allegations as causes of action implicating §§ 547 and 550 of avoidance and recovery of the property or value of the property threatened the Trust's property title. Thus, it fell within the scope of the 1987 ALTA policy purchased. In addition, any part of the claims falling within the policy's scope of coverage required Fidelity to defend against all claims.

Second, the Trust's attorneys tendering the Trust's claims to Fidelity provided Fidelity with sufficient facts and knowledge to determine the Bankruptcy Complaint allegations fell within the scope of the 1987 ALTA policy. Counsel described the relationship between LKE and the Trust and the § 1031 transaction through correspondence over a 12 month period.¹⁶² Although counsel refers to a 1992 ALTA policy in their correspondence, the factual disclosures to Fidelity would have been the same regardless of counsel's later discovery that Fidelity failed to deliver the purchased 1987 ALTA policy to the Trust. As counsel later determined, *the only indication* identifying the policy, is found on the first page in the lower right hand corner, in at best, 8-point size lettering— "ALTA POLICY - 1992 (10-17-92)."¹⁶³ Counsel discovered and fully realized the significance of the switch and breach of contract after the Trust sued Pulte and Fidelity.

Regardless, what the Trust's counsel did explain to Fidelity through correspondence from October 2000 to the Trust's settlement in October 2001 included assertions and conclusions that:

¹⁶² App. pp. 170; 174; 172-173; 174-175; 176-179.

¹⁶³ App. p. 151.

- The Trust did not receive cash from LKE from the proceeds of the relinquished property or used for the replacement property;
- The Trust received only title to the replacement property (Jackson County);
- The Trust and LKE performed their contractual duties to stay within IRS safe harbor regulations for a qualified intermediary. There is no evidence in the record or assertions from Fidelity or Pulte the Trust or LKE failed to perform their respective contractual duties to effect a § 1031 transaction;
- The money the Trust received directly from LKE, \$2,424.76 did not violate IRS § 1031 regulations. After receipt of all the replacement property, regulations allowed for the Trust to receive cash from LKE. It received \$2,424.76 and the difference between the proceeds of the relinquished Apple Valley property of \$600,000 and the final sales price of the replacement Jackson County property in the amount of \$589,864.82.

Under the Trust's purchased 1987 ALTA title insurance policy, Fidelity cannot show any part of the claims, or that it had knowledge to the contrary to the facts, to lead to Fidelity's determination not to defend the Trust. Although the Trust believes all of the claims are within the policy's scope of coverage, even if only a part of the Bankruptcy Complaint is arguably within the scope of protection of the 1987 ALTA purchased policy, Fidelity had a duty to defend the Trust.¹⁶⁴ Additionally, *if there is any ambiguity regarding coverage, it is resolved in favor of the insured*,¹⁶⁵ but there is no ambiguity. Simply, Fidelity owed the Trust a duty to defend.

The Bankruptcy Complaint jeopardized the Trust's property title at the moment of service. The bankruptcy trustee's actions required an immediate defense to an obvious threat. For instance, if the Trust did nothing and defaulted on the complaint, any determination of the court would have clouded the Jackson County property. The court

¹⁶⁴ *Auto-Owners Ins. Co. v. Todd*, 547 N.W.2d 696, 698 (Minn. 1996).

¹⁶⁵ *SCSC Corp. v. Allied Mutual Ins. Co.*, 536 N.W.2d 305, 316 (Minn. 1995).

could have either ordered the return of the property (recovery) or entered judgment for the value of the property (thus, a judgment lien on the title). It's as if waiting to defend a house about to be consumed in a forest fire. The obvious danger and possible outcome is apparent, but one does not wait for efforts to save the house after it is consumed by fire, but before, defending against the threat. Here, the Bankruptcy Complaint's paragraphs refer directly to Bankruptcy Code provisions and the powers of the bankruptcy trustee to do harm to the Trust's title. Fidelity had adequate notice and reason to defend the Trust.

C. When Pulte agreed to provide the Trust with a 1987 title insurance policy and later, Fidelity delivered a 1992 policy with coverage different than initially purchased, both Pulte and Fidelity breached their contracts with the Trust.

The lower court did not reach the Trust's claims against Pulte and Fidelity for breach of contract. Whether a contract exists is generally an issue for the factfinder.¹⁶⁶ However, the record is sufficient to adjudicate that the parties formed a contract as judged by the objective conduct of the parties.¹⁶⁷ Meanwhile, interpretation of a written contract is a question of law, which the appellate court reviews de novo.¹⁶⁸ In addition, whether an agreement is completely integrated and thus not subject to variance by parol evidence is an issue of law.¹⁶⁹

¹⁶⁶ *Morrisette v. Harrison*, 486 N.W.2d 424, 427 (Minn. 1992).

¹⁶⁷ *Cederstrand v. Lutheran Bhd.*, 263 Minn. 520, 532, 117 N.W.2d 213, 221 (1962).

¹⁶⁸ *Borgersen v. Cardiovascular Systems, Inc.*, 729 N.W.2d 619, 625 (Minn. App. 2007) citing *Alpha Real Estate v. Delta Dental Plan, Minn.*, 664 N.W.2d 303, 311 (Minn. 2003).

¹⁶⁹ *Borgersen*, 729 N.W.2d at 625.

1. The Trust contracted for a 1987 title insurance policy.

As the Minnesota Supreme Court has declared, “[t]he language found in the contract is to be given its plain and ordinary meaning.”¹⁷⁰ In construing any contract, the court is to give all terms their plain, ordinary and popular meaning so as to effect the intent of the parties.¹⁷¹ Likewise, as a matter of law, a breach of contract fails if the Trust cannot establish that it had been damaged by the alleged breach.¹⁷²

The Trust entered into a commitment, a contract for insurance or binder for insurance with Pulte. The contract identified the purchaser, the Trust; the type of title insurance policy, an “ALTA Residential Owner’s Policy – 1987” purchased for \$1,032.50, for the identified property; for the property value of \$589,864.82.

The purchased 1987 title insurance policy covered the causes of action asserted in the Bankruptcy Complaint. The Trust purchased that particular policy because the Trust wanted “a policy that would cover anything that could go wrong in a 1031 land exchange.”¹⁷³ Pulte agreed to deliver that policy and offered the 1987 policy. Furthermore, as Fidelity’s Vice-President and General Counsel in explaining the purpose of a title commitment:

Well, it is a commitment to issue a policy in the manner as set forth in the commitment showing the insured, referring to the property, raising the exceptions as listed, assuming or on the condition that the requirements are met on that particular schedule that lists requirements, and that the policy is paid for, which I think it does say that on there.¹⁷⁴

¹⁷⁰ *Turner v. Alfab Phi Sorority House*, 276 N.W.2d 63, 66 (Minn. 1979).

¹⁷¹ *Davis v. OutCNHrd Marine Corp.*, 415 N.W.2d 719, 724 (Minn. App. 1987).

¹⁷² *Jensen v. Duluth Area YMCA*, 688 N.W.2d 574, 578 (Minn. App. 2004).

¹⁷³ App. p. 73 (Rechtzigel Depo. at p. 85-86).

¹⁷⁴ App. p. 99 (Cozzi Depo. at p. 22).

However, the Trust did not get the policy it had bargained for. Nor is there any evidence to suggest Pulte's unambiguous written commitment did not fully integrate the complete understanding of the parties thus negating any parol evidence rule.¹⁷⁵ Nevertheless, Fidelity delivered a 1992 ALTA title insurance policy that excluded actions arising from federal bankruptcy actions.

Although it might be argued that the 1987 Residential Policy did not conform to the type of like-kind land transaction effected under 26 U.S.C. § 1031, the argument is of no avail. Fidelity admitted that it would have issued Fidelity's 1987 title insurance policy pursuant to the title commitment.¹⁷⁶ In addition, with the experience of completing 30 to 50 § 1031 transactions, Young stated that she could not recall the use of a 1992 ALTA policy being issued.¹⁷⁷ Pulte has since possibly created an issue of material fact, however, through a subsequent submission of Young's affidavit indicating that the title commitment form and the markings for a 1987 ALTA policy was an internal default mechanism generated through a computer program.¹⁷⁸

Yet, Pulte never advised the Trust of Pulte's internal office deficiencies, nor did Fidelity advise the Trust of Fidelity's disregard of Pulte's commitment to the Trust. And the only mark identifying the 1992 policy delivered to the Trust is found in the lower right hand

¹⁷⁵ *Flynn v. Sawyer*, 272 N.W.2d 904, 907-08 (Minn. 1978) (When an agreement is reduced to writing, parol evidence "is ordinarily inadmissible to vary, contradict, or alter the written agreement.")

¹⁷⁶ App. p. 98 (Cozzi Depo. at pp. 18-19).

¹⁷⁷ App. p. 31 (Young Depo. at p. 49).

¹⁷⁸ App. pp. 50-51.

corner of the first page approximately 8-point letter size, if not smaller — “ALTA OWNER’S POLICY – 1992 (10-17-92).”¹⁷⁹

There is no evidence in the record of Pulte or Fidelity advising the Trust of the policy switch or their inability to meet the terms of their respective contractual agreements. The Trust expected the parties to carry out the terms of their contracts and learned of their respective breach of contract only after the Trust tendered its claim to Fidelity.

2. The Trust suffered damages because of Fidelity’s and Pulte’s breach of contract.

Pulte and Fidelity breached their contract with the Trust. A breach of contract occurs when a party totally or partially fails to perform its obligation under the contract.¹⁸⁰ Not only did the Trust fail to receive the title insurance policy bargained for, the breach caused harm to the Trust.

The failure of Pulte and Fidelity to deliver the policy promised, resulted in Fidelity’s position that the delivered 1992 ALTA policy, containing a so-called “creditor’s rights exclusion,” formed a basis for Fidelity to deny the Trust a defense against the Bankruptcy Complaint. The creditor’s rights exclusion, in short, excluded from coverage any claim that arises out of the transaction by reason of a federal bankruptcy.¹⁸¹

¹⁷⁹ App. pp. 151.

¹⁸⁰ *Associated Cinemas of America v. World Amusement Co.*, 201 Minn. 94, 99, 276 N.W.2d 7, 10 (1937).

¹⁸¹ App. p. 152.

Fidelity's position not to defend caused the Trust harm in monetary damages. Because Fidelity did not defend the Trust,¹⁸² the Trust settled with the bankruptcy trustee for \$102,412.20 and "under duress."¹⁸³

Fidelity and Pulte breached the contracts they had with the Trust. They did not deliver the promised title insurance policy to protect the Trust's property title. The Trust had to fend for itself because a title insurance policy bargained for was not delivered as promised.

D. The Trust originally purchased a title insurance policy that covered threats to property title arising from bankruptcy actions, but when Pulte and Fidelity failed to inform the Trust of the substitution of that policy they committed acts of negligent misrepresentation.

The standard for appellate review for summary judgment is the applicable standard of review for negligent misrepresentation. The court must determine whether there is any material issue of fact and whether the lower court erred in applying the law.¹⁸⁴

1. Pulte and Fidelity owed a duty of care to the Trust regarding the title insurance policy purchased.

In Minnesota, a person making representations is "held to a duty of care only when supplying information, either for the guidance of others in the course of a transaction in which one has a pecuniary interest, or in the course of one's business, profession or

¹⁸² *American Std. Ins. Co. v. Le*, 551 N.W.2d 923, 926 (Minn. 1996) (An insured may recover from an insurer "damages resulting from breach of contract by the insurer's failure to defend.")

¹⁸³ App. p. 184. The settlement amount does not include attorney fees and costs associated with the Bankruptcy Compliant.

¹⁸⁴ *Zimmerman*, 605 N.W.2d at 729.

employment.”¹⁸⁵ And the standard of care for an insurance agent is “to perform at the level of skill of a reasonably prudent person in the insurance business.”¹⁸⁶

The Trust entered into a contract with Pulte for a particular title insurance policy identified by Pulte as an “ALTA Residential Owner’s Policy – 1987.”¹⁸⁷ And the commitment obligated Pulte and Fidelity to “issue a policy in a manner as set forth in the commitment.”¹⁸⁸ However, over two months later, Pulte sent to the Trust the policy it received from Fidelity, a 1992 ALTA policy, and not the 1987 policy the Trust purchased. Furthermore, the coverage of the 1992 ALTA policy differed than that of the 1987 ALTA policy.

As the Minnesota Supreme Court has stated, “[i]n the absence of a contractual undertaking by the agent or broker to provide insurance, the agent or broker has no legal duty toward an insured beyond that specifically undertaken by him or her.”¹⁸⁹ Pulte’s commitment obligated it — as a legal duty — to provide the Trust with the policy purchased with coverage for claims arising from bankruptcy actions. Under this doctrine, “without some evidence that reasonable care would have produced a better policy, there is no breach of duty . . .”¹⁹⁰ In this case, Fidelity ultimately substituted a policy with *less coverage* than the policy purchased thus Pulte, and Fidelity, breached their duty to the Trust.

¹⁸⁵ *Florenzano v. Olson*, 387 N.W.2d 168, 174 (Minn. 1986) citing *Bonhiver v. Graff*, 311 Minn. 111, 122, 248 N.W.2d 291, 298 (1976) quoting the *Restatement (Second) of Torts* § 552 (Tent. Draft No. 12 1966).

¹⁸⁶ *Hebrink v. Farm Bureau Life Ins. Co.*, 664 N.W.2d 414, 420 (Minn. App. 2003).

¹⁸⁷ App. pp. 137-141.

¹⁸⁸ App. p. 99 (Cozzi Depo. at p. 22).

¹⁸⁹ *Johnson v. Farmers & Merchants State Bank*, 320 N.W.2d 892, 898 (Minn. 1982).

¹⁹⁰ *Melin v. Johnson*, 387 N.W.2d 230, 232 (Minn. App. 1986).

2. Pulte and Fidelity failed to tell the Trust of the substitutions of title insurance policies.

Despite the fact that the Trust received coverage different than that purchased, no one — neither Pulte or Fidelity — advised the Trust of the change in coverage. In addition, there is no evidence in the record that shows a modification or requested change by the Trust to result in a substitution of policies.¹⁹¹ And, because of the substitution of policies, the Trust suffered a monetary loss because Fidelity refused to defend and cover the Trust against the causes of action in the Bankruptcy Complaint.

Pulte's admission of negligent misrepresentation is affirmed through Young's affidavit submitted to the lower court during summary judgment practice. In her affidavit, Young submits that the commitment form and the check off of the 1987 ALTA policy occurred because of an internal office computer default.¹⁹² However, there is no evidence in the record that reflects Young advising the Trust that the 1987 policy would be substituted for the 1992 policy or that the coverage would be different because of the substitution of policies.

Finally, there is nothing in the record of the unavailability of the 1987 ALTA policy. In fact, Fidelity issues policies with and without the so-called "creditor's rights exclusions."¹⁹³ Fidelity denied the Trust coverage with the substitution of the 1992 ALTA policy after LKE filed for bankruptcy. The 1992 ALTA policy had the "creditor's rights

¹⁹¹ App. p. 5. The lower court in its decision at page 5 regarding negligent misrepresentation, incorrectly stated the Trust had legal counsel representation when insurance was obtained from Fidelity. It is not clear where in the record the lower court found this reference.

¹⁹² App. p. 51.

¹⁹³ App. pp. 113-114 (Cozzi Depo. at pp. 79-83).

exclusions,” the basis for Fidelity to assert the policy prevented coverage for claims arising from federal bankruptcy actions.¹⁹⁴ But coverage was always available.¹⁹⁵

The Trust suffered damages when it settled with the bankruptcy trustee because Pulte and Fidelity failed to provide the Trust with the policy they promised to deliver. They never told the Trust of the substitution of policies. They never told the Trust the resulting change in coverage. Both Pulte and Fidelity failed in their legal duty to the Trust under the doctrine of negligent representation.

CONCLUSION

The Trust relied upon Pulte and Fidelity to deliver upon promises contractually agreed to protect it from threats, liens, or encumbrances to property title legally transferred through a qualified intermediary in a § 1031 like-kind land transaction. That the transferred property became a target of a bankruptcy trustee was not a creation of the like-kind transaction, but of the business practices of the qualified intermediary. However, the title insurance policy purchased protected the Trust’s property title from the causes of action alleged in the Bankruptcy Complaint. Fidelity had a duty to defend the Trust and failed to so.

Pulte and Fidelity also had a duty to provide the Trust with the 1987 ATLA title insurance policy purchased. That they substituted the policy for another with less coverage and coverage that did not cover the bankruptcy action is negligent behavior. But not to inform the Trust of the change is a breach of contract and a breach of duty to the insured.

¹⁹⁴ App. pp. 151-157.

¹⁹⁵ App. pp. 113-114 (Cozzi Depo. at pp. 79-83).

Their actions resulted in monetary harm to the Trust in the amount \$102,412.20 to settle with the bankruptcy trustee, and also attorney fees and costs.

The Trust seeks reversal of the lower court's decision or in the alternative, the Trust seeks reinstatement of its complaint for trial to resolve all material issues of fact and, judgment in accordance with this Appellate Court's decision on the law.

Dated: May 13, 2007.

MOHRMAN & KAARDAL, P.A.



Erick G. Kaardal, Attorney No. 229647
33 South Sixth Street, Suite 4100
Minneapolis, MN 55402-3601
Telephone: (612) 341-1074

Attorneys for Appellant Evelyn I. Rechtzigel
Trust, by its Trustees Frank Rechtzigel and
Gene Rechtzigel

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MOHRMAN & KAARDAL, P.A.



Erick G. Kaardal, Attorney No. 229647
33 South Sixth Street, Suite 4100
Minneapolis, MN 55402-3601
Telephone: (612) 341-1074