

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.

Reply Brief of Appellant

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

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INTRODUCTION

The Appellant, the Evelyn I. Rechtzigel Trust, submits its reply brief to address four arguments the Respondents Fidelity and Pulte raised in their response brief:

- Fidelity's apparent concession that Pulte's title commitment is a contract for a 1987 ALTA policy;
- An explanation of the bankruptcy code's authority to reach back to the original transaction thus affecting marketability of title and implicating title insurance coverage under its catch-all provision;
- Fidelity's accusation of the Trust's avoidance of the implication of the Trust's replacement property's warranty deed; and
- The significance of LKE's transfer of real property to the Trust versus the transfer of money in a bankruptcy action.

Ultimately, the arguments of Fidelity and Pulte are unpersuasive that Fidelity had no duty to defend and indemnify the Trust in a bankruptcy judicial action directly affecting the marketability of property title. Thus, all claims against Fidelity and Pulte should be sustained and the lower court's decision reversed.

LEGAL ARGUMENTS AND AUTHORITIES

A. The bankruptcy trustee's complaint was a judicial attack on the Trust's property title immediately implicating Fidelity's catch-all provision to cover for "[o]ther defects, liens, or encumbrances."

None of the terms "defect," "lien," or "encumbrance" are defined in Fidelity's ALTA policies. Nor does the purchased Fidelity 1987 ALTA policy exclude coverage of judicial bankruptcy actions that affect the marketability of title. Since the 1987 ALTA policy covers the Trust's title's marketability, and does not exclude bankruptcy

actions, the catch-all provision to cover for “[o]ther defects, liens, or encumbrances” required Fidelity to defend and indemnify the Trust against the bankruptcy action.

1. Fidelity concedes Pulte’s title commitment is a contract and binder thus, the Trust purchased a 1987 ALTA policy.

Fidelity makes no argument to the Trust’s interpretation of Pulte’s “Commitment”¹ as an insurance transaction with the Trust for the purchase of and binder for the 1987 ALTA policy protections. Fidelity referenced the Commitment once in its fact section asserting in parenthesis that “[it is] not a policy of title insurance.” Yet, Fidelity ignores the Trust’s previous statutory and legal analysis, and other existing case law that the title commitment is a policy or contract of indemnity:

A title commitment, which is issued at the time of closing, constitutes a policy or contract of indemnity by the title insurer. . . The issuance of a final policy after issuance of the title commitment merely confirms the obligations already undertaken by the title company.²

Likewise, as one treatise opines, citing *MacDonald v. Lawyers Title Insurance Corp.*³ where the court found the insurer had a duty to issue a policy as described in an erroneously issued title commitment that failed to include certain exclusions affecting property later litigated:

[O]nce an applicant has accepted the terms of a title insurer’s commitment to insure, acted to satisfy conditions set forth therein as precedent to issuance of a policy, and acquired the title, the insurer

¹ App. pp. 136-41.

² *Goettle v. Peters*, 639 N.Y.S.2d 660, 663 (1996) (citation omitted).

³ *MacDonald v. Lawyers Title Insurance Corp.*, 79 F.3d 1141 (4th Cir. 1996).

cannot refuse to issue a policy or unilaterally choose to issue a policy with different terms.⁴

Fidelity provides no contrary interpretation. Therefore, the Trust purchased the 1987 ALTA policy and all policy interpretations emulate from it and not the 1992 ALTA policy.⁵

Fidelity and the lower court further suggest that “neither Pulte nor Fidelity was [Appellant’s] insurance broker.”⁶ How could this be true? Pulte participated in the Trust’s closings (the relinquished property and the replacement property⁷) and offered title insurance. The Trust purchased title insurance, and relied on Pulte and Fidelity to provide the proper title insurance to protect the Trust’s Jackson County replacement property title.⁸ The Trust simply sought to purchase a policy to protect its property title not a phantom policy. As Fidelity notes: when “a broker undertakes to place insurance for another, it is his duty, in case he is unable to do so, to

⁴ Palomar, *Title Insurance Law*, Vol.1, § 5.23, 5-82 (Thomson/West 2005).

⁵ Fidelity disappoints the Trust with its assertion that the Appendix record is tainted with documents that “are not part of the standard form 1987 ALTA Owner’s Policy.” Fidelity Brief at p.12, fn. 3. Fidelity is mistaken. Appendix pages 147-150 were taken directly from Fidelity Vice-President and Regional Council Paul Cozzi’s deposition Exhibit 4. In other words, according to the deposition record, Exhibit 4 constituted pages 142-50 identified by Fidelity’s own document numbers FNTIC 0004-0012 as the entire 1987 ALTA policy. Cozzi testified to the authenticity of Exhibit 4 at Cozzi Depo. p. 18, App. p. 98. If the Court desires, counsel for the Trust will supplement the appendix with an entire copy of Cozzi’s deposition and exhibits.

⁶ Fidelity Brief at p. 32, citing App. p. 5.

⁷ App. pp. 25-26 (Young Depo. at 28-31).

⁸ App. pp. 26-27 (Young Depo. at 32-36).

seasonably notify his principal.”⁹ Furthermore, notice is required “to afford the principal an opportunity to secure, if he can, insurance elsewhere.”¹⁰

Fidelity insists that it has no insurance policy governing a § 1031 like-kind exchange. But the risk covered is the title to the Trust’s property. The title is exposed to risk because of the bankruptcy trustee’s authority to avoid the transfer in the first instance and obtain the real property or its value in the second instance. The risk to the property title is the essence of title insurance coverage and the risk to the Trust’s property title was embodied in the bankruptcy trustee’s complaint.

2. Fidelity ignores the effect of the bankruptcy action to the marketability of the Trust’s title.

Fidelity argues in its fact statement that “[n]ot surprisingly, the Preference Action led to no *lis pendens*, lien, encumbrance or any other document affecting the Replacement Property title. Indeed, Appellant owns the Replacement Property free and clear today.”¹¹ Fidelity, however, forgot to note the Trust’s engagement to defend itself in the litigation — eventually settling to clear its title.

The action of the Bankruptcy Trustee through her strong-arm power over the Trust’s property under §§ 547 and 550 — her claim — forced the Trust into litigation to remove defects of its title.¹² The definition of “defect” is broad enough to

⁹ *Backus v. Ames*, 79 Minn. 145, 149, 81 N.W. 766, 767 (1900).

¹⁰ *Id.*

¹¹ Fidelity Brief at p.14.

¹² *Maeser v. Cook, Voegelé & Nelson*, 446 N.W.2d 697, 698 (Minn. App. 1989) (“A title that may force the purchaser into litigation to remove defects is not marketable.”)

encompass all imperfections claimed or actual “regardless of validity.”¹³ Although Fidelity’s 1987 ALTA policy does not define “defect,” the Eighth Circuit Court of Appeals broadly defined “defect” determining that:

The plain and ordinary meaning of “defect” is broad, referring to any “fault or shortcoming or failing; imperfection..... Defect is the general word for any kind of shortcoming, imperfection, or deficiency, whether hidden or visible.” Random House Webster’s College Dictionary 347 (2d ed.1999). While courts use many terms to describe flawed titles, and the various types of flaws in title, (i.e., “cloud on title,” “encumbrance,” “defective title,” “unmarketable title”) the term “defect” itself is typically used in a broader sense that encompasses all the other terms.¹⁴

Thus, by the terms of Fidelity’s own policy its catch-all provision of “[o]ther defects, liens and encumbrances”, is inclusive coverage. Furthermore, because Fidelity did not define the term “defect,” the Trust cannot be reasonably expected to endure a narrower and more technical meaning than its plain and ordinary meaning.¹⁵

But Fidelity cites the lower court’s decision to narrow the construction of “defect.” As the lower court stated, “...nowhere does either policy state that it covers risks related to being sued for a monetary judgment. Rather, the common theme throughout both policies is that coverage is extended only to risks to title...”¹⁶ The

¹³ *United First Casualty Company v. Fidelity Title Insurance Company*, 258 F.3d 714, 719 (8th Cir. 2001).

¹⁴ *Id.*

¹⁵ *Id. citing Auto-Owners Ins. Co. v. Hanson*, 588 N.W.2d 777, 779-80 (Minn. App. 1999) (noting that Minnesota rejects a “terms of art” approach to interpreting undefined terms in an insurance policy).

¹⁶ Fidelity Brief at 20.

bankruptcy code provides the bankruptcy trustee with extraordinary authority to (1) *avoid* the entire transfer and (2) recover from the transferee the *property or its value*.¹⁷ How could this not be a “risk[] related to title”? Contrary to Fidelity’s argument, broad coverage does exist because the 1987 ALTA policy does not preclude bankruptcy actions.¹⁸ Fidelity could have excluded the title bankruptcy risk from coverage, but chose not to in the purchased 1987 ALTA policy. It did in Fidelity’s 1992 ALTA policy, but that is not what the Trust purchased.

Likewise, the bankruptcy action reached back to the § 1031 like-kind property transaction of February 28, 2000 and the risk to the marketability of title was an immediate “defect.” Fidelity argues because the bankruptcy action was filed in April 2000, “it is *impossible* that any Bankruptcy Court judgment would have been enforceable before the Policy Date.”¹⁹ Yet, a bankruptcy court’s decision to avoid the transfer will reach back to the date of transfer, as does the remedy of recovery if avoidance is inadequate.²⁰ If the transferred property — the replacement property — cannot be returned to the bankrupt estate, then the trustee can recover the fair market value of the property on the date of transfer.

Fidelity’s “impossibility” is the Trust’s “reality” under the Bankruptcy Code.

¹⁷ 11 U.S.C. §§ 547 and 550; § 547(b); *In re DLC, Ltd.*, 295 B.R. 593, 601 (8th Cir. BAP 2003).

¹⁸ For that matter, the policy also does not preclude coverage for monetary judgments.

¹⁹ Fidelity Brief at 21 (emphasis added).

²⁰ *In re Burns*, 322 F.2d 421, 427 (6th Cir. 2003).

Interestingly, Fidelity seeks to assert a policy date of March 8, 2000. By doing so, it suggests the Trust had no title insurance at the time of the February closing. Fidelity ignores Pulte's "Notice of Availability of Owner's Title Insurance" dated February 28, 2000,²¹ the date of closing, and Pulte's Commitment²² with the same date. Meanwhile, Pulte did not forward Fidelity's policy to the Trust until May 2000.²³ The May delivery date is also after LKE's April bankruptcy petition filing.²⁴

B. The warranty deed transferred title only at the time of its delivery by the grantor and acceptance by the grantee through LKE to the Trust.

Fidelity erroneously states the proposition that "Stroup transferred 'equitable title' to Appellant with the Purchase Agreement but retained "legal title" to the Replacement Property until it delivered the January 20, 2000 Deed transferring it to Appellant."²⁵ Fidelity is further mistaken that LKE "at *no point* ... [had] 'legal title' to the Replacement Property."²⁶

Under the doctrine of equitable conversion, once parties have executed a binding contract for the sale of real estate, equitable title vests in the vendee and the vendor holds only legal title as security for payment of the balance of the purchase

²¹ App. p. 136.

²² App. p. 137.

²³ App. p. 157A.

²⁴ App. p. 162, Bankruptcy Complaint at ¶ 4.

²⁵ Fidelity Brief at 27.

²⁶ *Id.* (emphasis added).

price.²⁷ Since the Trust *assigned its rights* to the Contract of Sale *to LKE*, LKE became the equitable fee owner, and at the moment of payment to Stroup held legal title to the property for the benefit of the Trust through the §1031 like-kind exchange. In other words, because Stroup received payment for the purchase price of the Jackson County replacement property, legal title passed to LKE, then to the Trust in the same § 1031 transaction, as intended, on February 28, 2000.

The sellers of the Jackson County replacement property executed a warranty deed in January 2000. The date of delivery however, occurred on February 28, 2000 from the sellers through LKE to the Trust. Fidelity suggests the Trust “completely ignores the January 20, 2000 Deed transferring title from Stroup *directly* to Appellant and the unequivocal language of the Phase 4 Agreement requiring title to be transferred from Stoup [sic] directly to Appellant.”²⁸ Fidelity follows the lower court’s determination that the “transfer of property was actually between Stoup [sic] and the Plaintiff directly. . . .”²⁹

First, the Trust did not ignore the warranty deed, but found it of little relevance to the overall transaction involving the §1031 like-kind property exchange in light of federal regulations governing § 1031 exchanges and property law governing deeds. The warranty deed is embodied within the Purchase Agreement provisions —

²⁷ *Tollefosn Deveopment, Inc. v. McCarthy*, 688 N.W.2d 701, 704 (Minn. App. 2003) citing *Stiernagle v. County of Waseca*, 511 N.W.2d 4, 5 (Minn. 1994).

²⁸ Fidelity Brief at p. 23.

²⁹ *Id.* and App. pp.3-4.

a fact Fidelity failed to note.³⁰ Furthermore, Fidelity's and the lower court's interpretations fail to appreciate a §1031 exchange and the LKE exchange agreement with the Trust. Finally, both interpretations suggest conduct that would have resulted in a failed § 1031 exchange which Fidelity has not dissected or otherwise concluded.

Second, the language of LKE's agreement with the Trust is unambiguous and under federal regulations governing delayed tax deferred exchanges:

To permit Exchangor [the Trust] to be entitled to the benefits of a delayed tax deferred exchange, the parties hereto agree as follows:

(a) In order to avoid the duplication of transfer fees, escrow costs, and the like, the parties agree that the obligation to make any deed transfer provided for herein may be fulfilled by the party obligated to make the transfer conveying title to the property directly to the intended transferee. Thus, on appropriate escrow instructions, title to the replacement property shall be conveyed from Seller [the Stoups family] to Exchangor³¹

There is nothing in the federal regulations governing § 1031 like-kind property exchanges prohibiting the contemplated acts embodied in paragraph (a) or any other paragraph of the exchange agreement. Fidelity has made no argument and produced no evidence that the parties to the § 1031 exchange failed to meet the federal statutory requisites to complete the tax deferred exchange of February 2000.

In fact, Fidelity cannot. As Pulte acknowledged, it participated in 30 to 50 like-kind exchange transactions.³² The Trust engaged in its first. Furthermore,

³⁰ App. p. 134, para. 8 of the Contract of Sale.

³¹ App. p. 130 (emphasis added).

³² App. p. 28 (Young Depo. at 40).

Fidelity implicitly misleads this Court, as the lower court mistakenly believed, that the Trust had “legal” counsel guiding the exchange transaction. There is nothing in the record to support the factual conclusion and is legally irrelevant. The legality of the §1031 transaction is *not* at issue. What is at issue is Fidelity’s and Pulte’s misrepresentations to the Trust, its failure to provide the Trust with the 1987 ALTA policy purchased, and Fidelity’s failure to defend and indemnify the Trust to protect its property title under that policy.

Third, the warranty deed requires delivery to transfer title.³³ The Minnesota Supreme Court has stated that acceptance is an integral part of delivery and “[n]o presumption of acceptance arises where the act is neither beneficial to nor later ratified by the grantee.”³⁴ Thus, the actual transfer of title through a deed is consummated on the date of delivery by the grantor and acceptance by the grantee, not by the date on the deed itself.³⁵

Therefore, the date of delivery occurred on February 28, 2000. The exchange agreement constituted the full understanding of all parties participating in the § 1031 like-kind exchange. The agreement identified the *real property* transferred to LKE as intermediary under a Phase 1 “Delayed Exchange & Assignment Agreement” dated January 17, 2000 (the “relinquished property”) and the Trust assigned its “rights, title, and interest to” the replacement *real property* in Jackson County to LKE. The parties

³³ *Slawik v. Loseth*, 207 Minn. 137, 139, 290 N.W. 228, 229 (1940).

³⁴ *Nybladh v. Peoples State Bank of Warren*, 247 Minn. 88, 93, 76 N.W.2d 429, 497 (1956)

³⁵ *See, City of Auburn v. Mandarelli*, 320 A.2d 22 (Me. 1974).

to the warranty deed executed in January 2000 fulfilled their obligations under the Contract of Sale — the “Purchase and Sale Agreement” — and provisions of the federal statutorily governed LKE § 1031 exchange and agreement to effect the transfer of title from Stroup to LKE, and then to the Trust, “to avoid the duplication” of costs and “the like.”

C. The bankruptcy action sought the transfer of real property, not money, since the only money transferred by LKE went to the sellers who were not defendants to the action

Fidelity’s legal analysis of bankruptcy law is minimal, yet asserts that “Appellant could not have been forced to divest its interest, or the value of its interest, to LK’s Bankruptcy Estate.”³⁶ Fidelity relies on *In re Nation-Wide Exchange Services, Inc.*³⁷ to conclude that if the *Nation-Wide* trustee could not “preserve legal title to replacement property for the benefit of the Bankruptcy Estate, neither could LK’s Trustee avoid LK’s transfer of the Replacement Property ...”³⁸

But the holding in *Nation-Wide* had nothing to do with the bankruptcy’s power to avoid the transfer of real property in a preference action or seek other bankruptcy remedies as contemplated under §§ 547 and 550 of the Bankruptcy Code against the property transferred. In fact, although the creditor/defendant in *Nation-Wide* received its property title from the bankruptcy trustee, the court entered a monetary

³⁶ Fidelity Brief at 30.

³⁷ *In re Nation-Wide Exchange Services, Inc.*, 291 B.R. 131 (Bankr. D. Minn. 2003)

³⁸ Fidelity Brief at 30.

judgment against the creditor/defendant for *money* of the net proceeds the creditor/defendant received during the 90 days preceding the bankruptcy filing.³⁹

In our case, LKE did not transfer *money* to the Trust, but transferred *real property* to the Trust.

In fact, if the bankruptcy trustee intended to avoid the transfer of *money only* as Fidelity suggests, then the trustee should have gone after Stroup. LKE did transfer *money* to Stroup, unlike the transfer of *real property* to the Trust.

For instance, if Fidelity defended the Trust it would have found paragraph 17 of the Bankruptcy Complaint to be false. LKE did not transfer payments to the Trust on February 15, 2000. And that the only payments made to the Trust from LKE amounted to \$14,984.70 moneys given to the Trust after the successful like-kind land transaction (\$600,000 - \$589,864.82 (actual payment for the replacement property) + \$2,424.76 (interest) = \$14,984.70). Therefore, the fact the bankruptcy trustee sought an amount greater than \$14,984.70 affirms that she targeted the Jackson County replacement property itself

Finally, Fidelity's arguments regarding any substance of the bankruptcy trustee's claims are relevant only if Fidelity tendered a defense for the Trust and asserted them during the bankruptcy litigation. These after-the-fact defenses of Fidelity have no relevance here.

Since the Bankruptcy Code under §§ 547 and 550 provides the bankruptcy trustee with the authority to avoid the transfer, seeking the property itself, or the

³⁹ *In re Nation-Wide Exchange Services, Inc.*, 291 B.R.at 136.

market value of the property, the marketability of the Trust's property title becomes immediately at risk. The Trust thus has come full circle, back to its initial argument that the purchased 1987 ALTA policy covers risks of the Bankruptcy Complaint's claims under the policy's catch-all provision governing "[o]ther defects, liens, or encumbrances."

CONCLUSION

The irony of Fidelity's entire brief is expressed in one sentence: "Appellant should have defended the Preference Action more vigorously... and avoided a loss altogether."⁴⁰ Fidelity suggests that the purchase of title insurance is an empty promise. Had Fidelity keep its promise, a vigorous defense might have prevented a loss. But the issues they should have raised in defense of the Trust are irrelevant here. Simply, Fidelity had a duty to defend the Trust under the 1987 ALTA policy purchased.

Accordingly, 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

⁴⁰ Fidelity Brief at p. 28.

material issues of fact and, judgment in accordance with this Court's decision on the law.

Dated: July 2, 2007.



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This brief complies with the type-volume limitations under Minn. R. Civ. App. P. 132.01, subd.3(a). This brief contains 2,849 words, excluding the parts of the brief allowed under appellate rules. This brief is written in Microsoft Word 2003 in Garamond type font and 13 point size.

Dated: July 2, 2007.

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