

## Louisiana Law Review

---

Volume 58 | Number 4  
*Summer 1998*

---

# What's the Matter With Zedda?: Problems With the Analysis of What Constitutes an Avoidable Interest of the Debtor in Property

Brandon A. Brown

---

### Repository Citation

Brandon A. Brown, *What's the Matter With Zedda?: Problems With the Analysis of What Constitutes an Avoidable Interest of the Debtor in Property*, 58 La. L. Rev. (1998)  
Available at: <https://digitalcommons.law.lsu.edu/lalrev/vol58/iss4/9>

This Note is brought to you for free and open access by the Law Reviews and Journals at LSU Law Digital Commons. It has been accepted for inclusion in Louisiana Law Review by an authorized editor of LSU Law Digital Commons. For more information, please contact [kreed25@lsu.edu](mailto:kreed25@lsu.edu).

# What's the Matter With *Zedda*?: Problems With the Analysis of What Constitutes an Avoidable Interest of the Debtor in Property

## I. INTRODUCTION

An elderly widower apparently sells his home to his daughter by recorded deed. The purpose—to enable the daughter to obtain a loan from a bank so the father could make much needed repairs to the house. In actuality, though, the transaction was a sham; no money changed hands, and the parties intended no transfer of ownership. Such transactions are labeled *simulations* in the civil law.<sup>1</sup> In a simulated sale, the parties' intent is given effect, and no ownership actually transfers.<sup>2</sup> However, in this instance, four years after the father supposedly sold the property to his daughter, the parties “undid” the original transaction on the public records by recording a counter letter.<sup>3</sup> A month later, the daughter officially transferred the property back to her father in a recorded sale.

Subsequently, however, the daughter files bankruptcy. The trustee of the daughter's estate files an action to avoid the effects of the recordation of the counter letter, and the transfer of the property back to the father, claiming the transfers were either fraudulent<sup>4</sup> or preferential.<sup>5</sup>

---

Copyright 1998, by LOUISIANA LAW REVIEW.

1. La. Civ. Code arts. 2025-2028.
2. La. Civ. Code art. 2026.
3. La. Civ. Code art. 2025. A counter letter is defined as a writing which expresses the true intent of the parties to a simulation.
4. See 11 U.S.C. § 548 (1997). Generally stated, a fraudulent transfer is a transfer by the debtor within one year prior to the filing of the bankruptcy, which was made with either the actual intent to defraud creditors, or for less than reasonably equivalent value. The statute, however, requires the presence of several other elements before a transfer may be avoided. 11 U.S.C. § 548 more fully provides:
  - (a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily—
    - (1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or
    - (2)(A) received less than reasonably equivalent value in exchange for such transfer or obligation; and
    - (B)(i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;
    - (ii) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or
    - (iii) intended to incur, or believed that the debtor would incur, debts that would be beyond the ability to pay as such debts matured.
5. See 11 U.S.C. § 547 (1997). Again, generally speaking, a preferential transfer is a transfer

This precise situation recently arose in the case, *In re Zedda*.<sup>6</sup> Both the bankruptcy and the district courts for the Eastern District of Louisiana agreed with the trustee, and found the daughter's transfer avoidable under the Bankruptcy Code.<sup>7</sup> The Fifth Circuit, however, reversed. *Held: Under Louisiana law, the original simulated sale to the daughter transferred nothing to her. When she deeded the property back to her father, she had nothing to transfer. Therefore, the recordation of the counter letter and deed were not transfers of the debtor of an interest in property, and, thus, were not subject to the trustee's avoidance powers.*<sup>8</sup>

An area of the civil law as peculiar to Louisiana as crawfish tails and boudin balls, the overarching structure of the federal Bankruptcy Code, and the inescapable logic of "nothing gained, nothing lost," all combined in *Zedda* to allow the father to keep the house he never intended to sell.<sup>9</sup> So—what's the matter with *Zedda*?

By holding the recordation of the counter letter and subsequent deed were not transfers of the debtor's interests in property, the Fifth Circuit has enunciated a disturbing definition of what constitutes an avoidable interest of the debtor in property for the purposes of fraudulent and preferential transfer actions by the estate. The court limits a trustee's power to avoid transfers by the debtor solely to those transfers involving ownership interests. Along the way, the court analyzes the problem by skewing the function and interplay of several Bankrupt-

---

by the debtor, on the "eve" of bankruptcy, to an existing creditor which has the effect of providing that creditor more than he would have received on the debt in the debtor's bankruptcy. 11 U.S.C. § 547 provides in full:

(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property—

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made—

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if—

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

6. 103 F.3d 1195 (5th Cir. 1997).

7. See *In re Zedda*, No. 91-10807, 1994 WL 421346 (E.D. La. Aug. 1, 1994), for district court's opinion and reasons for judgment as well as a discussion of the Bankruptcy Court's unreported judgment and reasons.

8. 103 F.3d 1195 (5th Cir. 1997).

9. Actually, during the litigation, with the consent of all parties, the trustee sold the house to an uninvolved third party. So, in effect, the father was allowed to keep the proceeds from that sale, not the actual house. *Zedda*, 103 F.3d at 1200.

cy Code provisions. And finally, the court ignores binding United States Supreme Court authority on the proper method for analyzing fraudulent and preferential transfer avoidance problems.

The purpose of this note is twofold: first, to expose the faulty basis and reasoning behind the holding in *Zedda*; second, to posit the proper method of analyzing the problem of what constitutes an avoidable interest of the debtor in property. To accomplish this purpose, it is necessary to discuss: (1) *In the Matter of Zedda*; (2) the history, purpose, and policy behind the Bankruptcy Code and its avoidance powers; (3) the link between the avoidance powers and the creation of the estate; (4) the history and scope of property of the estate; (5) the effects of a simulation under Louisiana law; (6) the confluence of Louisiana law and the Bankruptcy Code; and finally, (7) the proper function of the trustee's status as a hypothetical bona fide purchaser and the Louisiana Public Records Doctrine.

## II. THE CASE

### A. Facts

Ferdie Gaudet (Gaudet) and his wife, Emeldia Friloux (Friloux), owned property in New Orleans, Louisiana (Kenilworth property). The couple had two children, Ferdie J. Gaudet (Ferdie) and Janet Gaudet Zedda (Janet). In 1980, Friloux died. A state district court rendered a judgment of possession in 1986, recognizing that Gaudet owned one-half of the community property, including the Kenilworth property, and also recognizing the usufruct of the surviving spouse over the remainder of the property.<sup>10</sup> The judgment of possession also recognized that Ferdie and Janet, as Friloux's children and heirs, were entitled to the naked ownership of an undivided one-fourth of the deceased's portion of the community property.<sup>11</sup>

---

10. *Zedda*, 103 F.3d at 1199. The usufruct of the surviving spouse derives from La. Civ. Code art. 890 which provides, in part, ". . . the surviving spouse shall have a usufruct over so much of that share as may be inherited by descendants." Under Louisiana community property laws, each spouse owns one-half of the total community. La. Civ. Code art. 2336. Absent a last will or testament directing differently, Louisiana's law of intestate successions dictates that descendants automatically inherit the interest of the deceased in community property. La. Civ. Code art. 888. Only if the deceased leaves no descendants will the surviving spouse succeed to the deceased's community property interest. La. Civ. Code art. 889. Therefore, in a normal intestate succession, the surviving spouse will retain his or her one-half interest in the community, while the deceased's interest devolves to her descendants. Article 890, however, allows the surviving spouse to retain a usufruct over the deceased's portion of the community in addition to his one-half. A usufruct is defined by the Civil Code as a real right of limited duration on the property of another, whose features depend on the nature of the thing subject to it. La. Civ. Code art. 535. The residual interest on land burdened by a usufruct is designated as the naked ownership. La. Civ. Code art. 478; cf. La. Civ. Code art. 477 (detailing the elements of perfect ownership). The descendants, thus, inherit only the naked ownership of the deceased's portion of the community.

11. *Zedda*, 103 F.3d at 1199. According to the Civil Code, descendants inherit equal portions in intestate successions. La. Civ. Code art. 888. Since the decedent's portion of the community was

By the time the judgment of possession was rendered, the community home, located on the Kenilworth property, needed extensive repair. Gaudet had previously attempted to gain financing from the bank, but was told that the bank would not lend him any money since his only income was from Social Security.<sup>12</sup> The same day the judgment of possession was rendered, Gaudet and Ferdie executed an Act of Sale (1986 deed), apparently conveying the Kenilworth property to Janet.<sup>13</sup> Janet then successfully borrowed \$30,000 from the bank for repairs to the Kenilworth home.<sup>14</sup>

By 1990, Ferdie began expressing concerns about the property remaining in Janet's name. To resolve this discord, Gaudet instructed Janet to transfer record title back to his name. On June 6, 1990, Janet executed a counter letter declaring the 1986 deed had placed title in her name for convenience only, and that the sale was, in actuality, a simulation.<sup>15</sup> The counter letter was properly recorded two days later, on June 8, 1990.<sup>16</sup> Four months later, on October 5, 1990, Janet officially conveyed the property back to Gaudet in an act of sale (the 1990 deed).<sup>17</sup>

On March 4, 1991, Janet and her husband (collectively, the debtors) filed a petition for relief under Chapter 7 of the Bankruptcy Code.<sup>18</sup> Upon the filing of a petition under Chapter 7, a trustee is appointed to administer the estate.<sup>19</sup> The trustee subsequently filed an action to avoid the effects of the recordation of the counter letter and 1990 deed as either a fraudulent transfer pursuant to Section 548, or as a preferential transfer under Section 547 and thereby bring the property into the bankruptcy estate. The Bankruptcy Court agreed with the trustee. It found the transfers to be fraudulent, as defined by the Bankruptcy Code, and allowed the trustee to avoid the transfers and recover the entire net proceeds for the benefit of the estate.<sup>20</sup> Gaudet appealed to the United States District Court for the Eastern District of Louisiana. The District Court affirmed

---

one-half, Ferdie and Janet each inherited one-half of one-half the total community property. In other words, each received one-fourth. *See also supra* note 10.

12. *Zedda*, 103 F.3d at 1198-99.

13. *Id.* at 1199. The act recited a consideration of \$85,028.86, however, Janet never actually paid anything to either of the apparent vendors.

14. *Id.* The bank secured the loan with a mortgage granted by Janet on the Kenilworth property. The mortgage was properly recorded in Orleans Parish on February 4, 1987.

15. *Id.* at 1199.

16. *Id.*

17. *Id.* The act was properly recorded on October 9, 1990. The act recited consideration of \$54,000 plus assumption of the \$26,000 outstanding mortgage balance. An addendum to the act stated that actually, the 1990 deed transferred only Janet's one-fourth naked ownership interest she inherited from her mother. Consideration paid Janet for this one-fourth interest totaled only \$9,000. The addendum additionally stated that the 1986 deed had been for convenience only, and no consideration was ever paid. The addendum, however, was never recorded.

18. *Id.* at 1199-1200.

19. 11 U.S.C. § 701 (1997).

20. *Zedda*, 103 F.3d at 1200.

the Bankruptcy Court's ruling.<sup>21</sup> Gaudet again appealed, this time to the United States Fifth Circuit Court of Appeals. The Fifth Circuit agreed with Gaudet and reversed the District and Bankruptcy Courts.<sup>22</sup>

*B. The Fifth Circuit's Analysis*

The lower courts held that, based on Louisiana's Public Records Doctrine,<sup>23</sup> the debtors had an interest in property which was transferred by the recordation of the counter letter and the 1990 deed. Therefore, the transfers were avoidable by the trustee.<sup>24</sup>

The Fifth Circuit, however, took a different approach. It reasoned that Section 544<sup>25</sup> of the Bankruptcy Code embodies and effectuates the policies of state registry laws such as those commonly referred to as the Louisiana Public Records Doctrine. Section 544 provides that the trustee assumes the status of a bona fide purchaser over all the debtor's property. The characteristics of bona fide purchasers, for purposes of the Bankruptcy Code, are defined by resort to state law.<sup>26</sup> Under Louisiana law, since all interests affecting immovable property are required to be recorded,<sup>27</sup> a bona fide purchaser may defeat the

---

21. In re Zedda, No.91-10807, 1994 WL 421346 (E.D. La. Aug. 1, 1994). See also Zedda, 103 F.3d at 1200.

22. Zedda, 103 F.3d 1207.

23. The Public Records Doctrine is embodied at Louisiana Revised Statutes 9:2721-2733 (1991 & Supp. 1998). Most significant is Louisiana Revised Statutes 9:2721(A) which provides:

No sale, contract, counter letter, lien, mortgage, judgment, . . . or other instrument of writing relating to or affecting immovable property shall be binding on third persons or third parties unless and until filed for registry in the office of the parish recorder of the parish where the immovable is situated. Neither secret claims or equities nor other matters outside the public records shall be binding on or affect such third parties.

La. R.S. 9:2721(A) (Supp. 1998). Louisiana Revised Statutes 9:2722 defines the class of persons protected by the registry laws to be:

Third persons or third parties so protected by and entitled to rely upon the registry laws of Louisiana now in force and effect . . . are hereby redefined to be and to include any third person or third party dealing with any such movable or immovable property or acquiring a real or personal right therein as purchaser, mortgagee, grantee or vendee of servitude or royalty rights, or as lessee in any surface lease or leases or as lessee in any oil, gas, or mineral lease and all other third persons or third parties acquiring any real or personal right, privilege or permit relating to or affecting immovable property.

La. R.S. 9:2722 (1991).

24. The presence of a transfer of an interest of the debtor in property actually makes the transfer only possibly avoidable. See *supra* notes 4 and 5 for full statutory requirements needed to actually be able to avoid a transfer.

25. 11 U.S.C. § 544(a) (1997) states:

(a) The trustee shall have, as of the commencement of the case, . . . the rights and powers of, or may avoid any transfer of property of the debtor . . . that is voidable by—

(3) a bona fide purchaser of real property . . . from the debtor . . .

26. *Butner v. United States*, 440 U.S. 48, 55, 99 S. Ct. 914, 918 (1979) ("Property interests are created and defined by state law.")

27. La. R.S. 9:2721 (Supp. 1998).

rights of other claimants to the property based on the absence of recordation of their adverse interests.<sup>28</sup> In sum, the status of a bona fide purchaser entitles the holder to prevail against the claims of any holders of interests in the property which were required to be recorded, but were not.<sup>29</sup>

The Fifth Circuit agreed with the district court that had Janet not recorded the counter letter and 1990 deed, the Kenilworth property would have become property of the estate.<sup>30</sup> The court attributed this hypothetical result to the trustee's status under Section 544 as a bona fide purchaser under state law.<sup>31</sup> The court reasoned that ownership is an interest in property, and as such it must be recorded to affect third persons. Since Janet would have had the only recorded interest in the Kenilworth property, had the counter letter and 1990 deed not been executed, then the public records doctrine would protect the trustee, by virtue of his status as a bona fide purchaser under Section 544, from the unrecorded ownership interest of Gaudet. Thus, according to the court, the estate would acquire the Kenilworth property under the authority of Section 544.<sup>32</sup>

However, the Fifth Circuit noted, Section 544 does not allow one to hypothetically undo a transaction.<sup>33</sup> An express temporal limitation is implanted into Section 544; the trustee has status of a bona fide purchaser *only* at the commencement of the case.<sup>34</sup> When the petition was filed, the counter letter and 1990 deed had been recorded. Therefore, at the commencement of this case, the trustee's status as a bona fide purchaser would not prime the ownership interest of Gaudet since, at that time, Gaudet's ownership interest was recorded (by virtue of the 1990 deed).<sup>35</sup> The court concluded its analysis of the Louisiana Public Records Doctrine and estate property under the Bankruptcy Code by stating:

[T]he Trustee is not allowed to reach back to some arbitrary, anterior time and invoke the public records rights of a . . . purchaser as of that date, particularly when it is recognized that no actual . . . purchaser could do so. Section 544 does nothing more than put the Trustee in the exact

---

28. William V. Redmann, *The Louisiana Law of Recordation: Some Principles and Some Problems*, 39 Tul. L. Rev. 491 (1965).

29. La R.S. 9:2721, 2722 (1991 & Supp. 1998); *Phillips v. Parker*, 483 So. 2d 972, 975 (La. 1986). See also Redmann, *supra* note 28, at 511. It is interesting to note that in Louisiana, there is no requirement that a third party have actual "good faith" to be a bona fide purchaser. Actual knowledge of existing adverse interests is of no moment in the Louisiana Public Records Doctrine. The recorded interest will prime all unrecorded interests, regardless of the recording party's knowledge of outstanding interests. *McDuffie v. Walker*, 125 La. 152, 51 So. 100 (1909); *Harang v. Plattsmier*, 21 La. Ann. 426 (1869).

30. *In re Zedda*, 103 F.3d 1195, 1202 (5th Cir. 1997).

31. *Id.*

32. *Id.*

33. *Id.* at 1203.

34. 11 U.S.C. § 544(a) (1997), "The trustee shall have, as of the commencement of the case . . ." Additionally, "commencement of the case" is synonymous with the filing of the petition under 11 U.S.C. §§ 301-303 (1997).

35. *Zedda*, 103 F.3d at 1203.

same shoes as those of such a third party [at the moment of bankruptcy]; it does not give the Trustee either stilts or Seven League boots to augment the ordinary footwear of the hypothetical . . . purchaser.<sup>36</sup>

Continuing its analysis, the court noted an absolute lack of any link between the powers granted the trustee by Section 544 and those granted by Sections 547 and 548.<sup>37</sup> Under Section 544, the trustee may recoup assets, and avoid claims against the debtor's assets based on the status of the debtor's estate as of the moment of the filing of the petition. On the other hand, Sections 547 and 548 allow the trustee to avoid transfers of the debtor's assets regardless of the status of the debtor's estate at the commencement of the case. If the transfer was made during the statutorily prescribed time period, and was of an interest of the debtor in property, then the trustee may attack the transfer as fraudulent or preferential.<sup>38</sup> As the district court observed, "To read §544(a) into §548 [and/or §547] would completely vitiate the trustee's power under §548 [and §547] . . . ."<sup>39</sup> The Fifth Circuit agreed, and in its own words stated, "We discern no authority whatsoever in §544 . . . for making such a [link]; certainly none can be gleaned from §548 [or §547]. Frankly, we are unwilling to engage in the kind of judicial legislation . . . necessary to give the Trustee this fictional and unauthorized power to link §§544 and 548."<sup>40</sup> Accordingly, since protection of the public records doctrine is solely limited to Section 544, and the underlying adversary action was premised on Sections 547 and 548, the trustee could not avail himself of the debtor's record title in the Kenilworth property. According to the court, such title, crucial to the trustee's powers under Section 544, is wholly irrelevant to his Sections 547 and 548 powers.<sup>41</sup>

Having severed the trustee's public records protection from any preferential or fraudulent transfer analysis, the court proceeded to analyze whether the counter letter and 1990 deed constituted transfers of an interest of the debtor in property. Under either the preferential or fraudulent transfer statutes, the trustee

---

36. *Id.*

37. *Id.* at 1201.

38. As noted before, the necessity that a transfer be of an interest of the debtor in property is merely a threshold requirement. Once surmounted, additional hurdles await. The trustee may attack the transfer if it is found to be of an interest of the debtor in property, but it will only be deemed fraudulent or preferential if it meets the other requirements of either statute. See *supra* notes 4 and 5 for statutory description of fraudulent and preferential transfers.

39. In re *Zedda*, No. 91-10807, 1994 WL 421346, at \*4 (E.D. La. Aug. 1, 1994). Whether or not linking Section 544 with Sections 547 and 548 vitiates the trustee's powers under that section is a matter for debate. The author feels the point the court wishes to express is that by allowing the trustee to rely on his bona fide purchaser status under Section 544 in the context of a preferential or fraudulent transfer avoidance action is meaningless since Section 544 specifically attaches at the commencement of the case, whereas any transfer to be avoided by actions under Sections 547 or 548 necessarily occurred before the commencement of the case.

40. *Zedda*, 103 F.3d at 1203.

41. *Zedda*, 103 F.3d at 1204.



may avoid such transactions if they are of an interest of the debtor in property.<sup>42</sup> The court began its analysis with the observation that state law controls whether the debtor had an interest in the property.<sup>43</sup> The court found that under Louisiana law, the original 1986 deed was an absolute simulation since the parties never intended to transfer ownership.<sup>44</sup> Regardless of the effects a simulated sale has on third parties, it does not actually transfer ownership between the parties.<sup>45</sup> The court concluded that the focus under Sections 547 and 548 is on *actual ownership*, not mere record title.<sup>46</sup> Since the 1986 deed had no effect between the parties under Louisiana law and transferred no actual ownership, Janet had nothing to transfer in the 1990 deed and counter letter.<sup>47</sup> Therefore, since the transfers did not meet the initial requirement of being of an interest of the debtor in property, the trustee was not allowed to avoid the transfers as either fraudulent or preferential.<sup>48</sup>

### C. *The Matter with Zedda*

*Zedda* is wrong; not only in result, but more importantly, in its analysis of the problem. The Fifth Circuit made three mistakes. The first was interpreting the trustee's bona fide purchaser status as an ability to capture property for the benefit of the estate. As will be shown later, Section 544(a)(3) is defensive in posture, allowing the trustee merely to defeat some adverse claims to property in which the debtor already holds an existing interest, not to acquire interests the debtor does not or no longer has. The second mistake, however, was that the

42. 11 U.S.C. §§ 547, 548 (1997). See *supra* notes 4 and 5. Both statutes actually require that the transaction be a "transfer" of an interest of the debtor in property. Transfer is defined by the Bankruptcy Code as every conceivable mode of alienating property, whether direct or indirect, voluntary or involuntary. 11 U.S.C. § 101(54) (1997); *In re Criswell*, 102 F.3d 1411, 1415 (5th Cir. 1997).

43. 103 F.3d at 1204. Technically, this observation is incorrect. The Supreme Court has repeatedly stated that *absent any controlling federal law*, "'property' and 'interests in property' are creatures of state law." *Barnhill v. Johnson*, 503 U.S. 393, 398, 112 S. Ct. 1386, 1389 (1992); *Butner v. United States*, 440 U.S. 48, 55, 99 S. Ct. 914, 918 (1979). One example of overriding federal interests is joint holder United States Savings Bonds. Such bonds are created and regulated by the federal law, not state law. 31 U.S.C. § 3102 (1996). It must be kept in mind, however, even when federal law does not create the interest, and state law does, whether a particular interest is avoidable is nonetheless a federal question. 11 U.S.C. §§ 541, 547, 548 (1997). See *infra* note 84.

44. *Zedda*, 103 F.3d at 1204-05.

45. La. Civ. Code art. 2026.

46. *Zedda*, 103 F.3d at 1206.

47. *Id.* at 1207. It must be noted that at all times prior to the 1990 deed, Janet did hold the naked ownership of an undivided one-fourth of the property she inherited from the death of her mother, Friloux. See *supra* note 11. In fact, Janet conveyed this interest in the 1990 deed for the sum of \$9,000. However, this note is not concerned with this portion of that transaction. The transfer of the one-fourth interest is clearly of interest of the debtor in property. This note is, and the Fifth Circuit was, concerned with the potential interests transferred by the simulated sale memorialized by the 1986 deed.

48. *Id.*

court missed the federal nature of the inquiry into whether a debtor holds an interest in property. State law merely controls whether an interest exists, not whether an interest is subject to avoidance by a trustee in bankruptcy. Finally, the court equates the term, "interest of the debtor in property," with ownership under state law.<sup>49</sup> The Fifth Circuit offers no authority for this proposition, which, incidentally, directly contradicts the congressionally-intended scope of avoidance actions, the fundamental policies of the Bankruptcy Code, and binding United States Supreme Court precedent. This note will address these errors in reverse order, because by finding the proper scope of property subject to avoidance actions, and positing it in the proper analytical framework, the issue of the proper role and function of the Louisiana Public Records Doctrine and the trustee's status under Section 544 resolves itself.

### III. A BRIEF HISTORY OF THE BANKRUPTCY CODE AND AVOIDANCE ACTIONS

To understand the case, the error of the Fifth Circuit's reasoning, and the impact it has on future avoidance problems, a brief background of the history and purpose of the Bankruptcy Code is necessary. From the inception of our federal government, Congress has had authority, by virtue of the Constitution, to make all laws respecting bankruptcies.<sup>50</sup> In accordance with this authority, Congress enacted the present Bankruptcy Code in 1978.<sup>51</sup>

A driving principle and central policy behind all enactments of the Bankruptcy Code is equality of distribution among creditors.<sup>52</sup> Accordingly, the Bankruptcy Code allows equally situated creditors to participate equally, or pro rata, in the distribution of the debtor's estate.<sup>53</sup>

To further this policy, the Code allows the trustee to recoup property transferred by the debtor before bankruptcy which either preferred certain creditors to the detriment of other creditors, or depleted the debtor's assets in fraud of the debtor's creditors.<sup>54</sup> Although a fraudulent transfer and a preferen-

---

49. *Id.* at 1206 ("The focus of § 548(a)(2) is on *actual ownership—not mere record title.*") (emphasis added).

50. U.S. Const. art I, § 8, cl. 4, which provides the Congress has the authority to establish, "uniform Laws on the subject of Bankruptcies throughout the United States."

51. Bankruptcy Act of 1978, Pub. L. 95-598, 92 Stat. 2549-2651 (now codified at 11 U.S.C. §§ 101-1330 (1994)). In all, Congress has enacted laws on bankruptcies five times: Bankruptcy Acts of 1800, 2 Stat. 19; of 1841, 5 Stat. 440; of 1867, 14 Stat. 517; of 1898, 30 Stat. 544; and the present act of 1978.

52. *Begier v. I.R.S.*, 496 U.S. 53, 58, 110 S. Ct. 2258, 2262 (1990).

53. *Id.* at 58, 110 S. Ct. at 2262-63. *See, e.g.*, 11 U.S.C. § 726(b) (1994) (generally mandating pro rata distribution to unsecured creditors in a Chapter 7 liquidation). *See also* H.R. Rep. No. 95-595, at 177-78 (1977).

54. 11 U.S.C. §§ 547, 548 (1994). *See also* 11 U.S.C. § 544(a)(1) (1194) (conferring on the trustee the status of a judgment lien creditor as of the commencement of the case, which, in turn,

tial transfer outside of bankruptcy are not of the same quality, either in conscience or in law,<sup>55</sup> both forms of transfer deplete the debtor's patrimony (i.e., the debtor's economic value) to the detriment of creditors holding outstanding claims. A transfer in fraud of creditors has been observed as inherently and always vicious; in other words, as *malum per se*.<sup>56</sup> A preferential transfer, however, is generally innocent and valid, except when it is made in violation of the express provisions of a statute. In that context, it is said to be *malum prohibitum*, but only to the extent it is forbidden.<sup>57</sup> A transfer to a creditor on the eve of bankruptcy in preference over the other creditors thus violates the rule and policy of equal distribution among all creditors. A fraudulent transfer, on the other hand, goes even further. By it, the debtor seeks to obtain a personal advantage out of what, in law, should belong to the creditors and not the debtor. A fraudulent transfer, therefore, forces all creditors to take less than they would have had they been able to participate in a division of the estate before the debtor transferred the property.<sup>58</sup> Sections 547 and 548 accomplish the policy of equality of distribution by allowing the trustee to avoid such fraudulent and preferential transfers, and recoup property which would have been available for distribution to the creditors had the transfers not taken place.<sup>59</sup>

#### IV. LINKING AVOIDANCE ACTIONS WITH PROPERTY OF THE ESTATE

As noted previously, the *Zedda* court began its analysis by severing any public records protection from the avoidance inquiry. The Fifth Circuit is absolutely correct in its premise that the trustee's public records protection under Section 544 has nothing to do with whether he may successfully avoid a transfer as either fraudulent or preferential. The focus from the start of an avoidance problem is, *did the debtor transfer any interest she held?* At the time of any fraudulent or preferential transfer, there is no bankruptcy, and thus, no trustee. Therefore, the trustee's status has no bearing on a fraudulent or preferential transfer avoidance analysis.

The starting point for any avoidance inquiry is to define the phrase "interest of the debtor in property," as it is used in Sections 547 and 548.

The primary consideration of Sections 547 and 548 is that there be a transfer of an interest *of the debtor* in property.<sup>60</sup> This consideration stems from the fact that "if the debtor transfers property that would not have been available for

---

allows the trustee to use state law fraudulent conveyance actions, such as the revocatory action under Louisiana law). La. Civ. Code art. 2036.

55. *Van Iderstine v. National Discount Co.*, 227 U.S. 575, 582, 33 S. Ct. 343, 345 (1913).

56. *Id.*

57. *Id.*

58. 4 *Collier on Bankruptcy* ¶ 547.01, at 547-12 (Lawrence P. King ed., 15th ed. 1995).

59. *Begier v. IRS*, 496 U.S. 53, 58, 110 S. Ct. 2258, 2263 (1990).

60. 11 U.S.C. §§ 547(b), 548(a) (1994).

distribution to his creditors, the policy behind the avoidance power is not implicated."<sup>61</sup> If the debtor transfers something which is not his, then, presumably, it would not have been available for distribution to his creditors.<sup>62</sup>

Although the Bankruptcy Code does not define what is meant by the phrase "interest of the debtor in property," as it is used in the avoidance action sections, it must be noted that the phrase is identical to the definition of the estate in Section 541.<sup>63</sup> When a bankruptcy is filed, Section 541 creates an estate composed of all "interests of the debtor in property."<sup>64</sup> Since Sections 547 and 548 mirror Section 541's definition of "property of the estate," the United States Supreme Court has held that the scope of what constitutes an "interest of the debtor" in property under Sections 547 and 548 is coextensive with "interests of the debtor in property" as that term is used in Section 541.<sup>65</sup> Therefore, when determining whether a transfer is of an interest of the debtor in property, for purposes of trustee avoidance actions, guidance must be sought from Section 541's definition of property of the estate, which serves as the post-petition analog to the avoidance actions' focus on the pre-petition interests of the debtor in property.<sup>66</sup> Therefore, the question to be answered when analyzing an avoidance problem is: would the property have become property of the estate under Section 541 had the transfer not taken place?<sup>67</sup>

## V. THE HISTORY AND SCOPE OF PROPERTY OF THE ESTATE UNDER SECTION 541

### A. The History

Under the Bankruptcy Act of 1898, at the commencement of the bankruptcy proceeding, the estate succeeded to all the debtor's title to property.<sup>68</sup> Most importantly, the estate became comprised of *all* property which the

---

61. *Begier*, 496 U.S. at 58, 110 S. Ct at 2263.

62. See generally 11 U.S.C. § 541(d) (1994) (codifying the constructive trust doctrine). See also *Begier*, 496 U.S. 53, 110 S. Ct. 2258 (1990), for discussion of constructive trusts.

63. 11 U.S.C. § 541(a)(1) (1994) provides that the debtor's estate is comprised of, "all legal and equitable interests of the debtor in property as of the commencement of the case." (emphasis added).

In 1984, Section 547 was amended, substituting the phrase "interest of the debtor in property" in place of the phrase "property of the debtor." Pub. Law No. 98-353, § 462(b)(1), 98 Stat. 378 (1984).

64. 11 U.S.C. § 541(a)(1) (1994).

65. *Begier*, 496 U.S. at 59, 110 S. Ct. at 2263 n.3. Although the Court in *Begier* was limited by the facts of the case to consideration of the scope of Section 547, the underlying rationale applies equally to Section 548 since it too uses the identical phrase "interest of the debtor in property."

66. *Begier*, 496 U.S. at 58-59, 110 S. Ct. at 2263.

67. *Id.* at 58, 110 S. Ct. at 2263. See also *Besing v. Hawthorne*, 981 F.2d 1488, 1493 (5th Cir. 1993).

68. Bankruptcy Act of 1898, § 70(a), 30 Stat. 544, 565-566, provided: "The trustee of the estate of a bankrupt, . . . shall in turn be vested . . . with the title of the bankrupt, as of the date he was adjudged a bankrupt, . . . to all (1) documents relating to his property; (2) interests in patents,

debtor could have sold, or creditors could have seized to satisfy his debts.<sup>69</sup> It must be noted that the main thrust of Section 70(a)(5) is to secure for creditors everything of value the bankrupt may possess in alienable or leviable form.<sup>70</sup> Throughout its history, the term property, as used in Section 70(a)(5), was construed most generously.<sup>71</sup> Interests were not considered outside its reach because they were novel, contingent, or burdened with conditions or restrictions.<sup>72</sup>

For example, in *Board of Trade of Chicago*<sup>73</sup> and *Page v. Edmunds*,<sup>74</sup> the United States Supreme Court encountered the question of whether commodity exchange seats were "property" under Section 70(a)(5). In *Board of Trade of Chicago*, the seat was "purchased" with a membership fee in the trade association. The seat could be transferred by the holder to any person qualified and eligible for membership in the association, with the approval of nine of the ten members of the Board. However, other members could prevent the transfer if they held unpaid claims against the holder by filing objections with the Board.<sup>75</sup> When the debtor attempted to transfer his seat, two member/creditors objected. The debtor then filed for bankruptcy, and his trustee attempted to claim the seat on the exchange. The Board claimed the seat was not property. The Supreme Court, however, found that the debtor could transfer or sell the seat, subject to the creditors' right to prevent the transfer until he settles his debt with them.<sup>76</sup>

---

patent rights, copyrights, and trade-marks; (3) powers which he might have exercised for his own benefit, but not those which he might have exercised for some other person; (4) property transferred by him in fraud of his creditors; (5) property which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him . . . ." (emphasis added).

69. See *supra* note 68 for full statute. This note will focus entirely on Section 70(a)(5) when discussing property of the estate under the Bankruptcy Act of 1898. Although Section 70(a)(4) ostensibly grants the trustee title to property transferred by the debtor in fraud of his creditors, the intent of that section was to vest the estate with title to property recovered by the trustee. In turn, the trustee was impliedly vested with the power under state and federal law to recapture the property under Section 70(e). See 4A *Collier on Bankruptcy* ¶ 70.14[1] (James William Moore ed., 14th ed. 1978). See also *Glenny v. Langdon*, 98 U.S. 20, 22, 27-31 (1878) (stating actions to avoid such fraudulent transfers vest in the trustee). Under the old Section 70(a)(4), then, the trustee had the power to recover the property the debtor transferred. However, this begs the question of what constituted property such that the trustee could seek to recover it (the exact problem faced by the courts in *Zedda*). Guidance must have been sought from some other definitional provision of the Act. Since subsection (5) provides a solid definition of property of the estate (and more germane to the issues in *Zedda* than papers, patents, and exercise of rights contained in subsections (1), (2), and (3)), this note focuses on its provision rather than the fraud provision in subsection (4).

70. *Segal v. Rochelle*, 382 U.S. 375, 379, 86 S. Ct. 511, 515 (1966).

71. *Id.*

72. *Id.*; *Board of Trade of Chicago v. Johnson*, 264 U.S. 1, 44 S. Ct. 232 (1923).

73. *Board of Trade*, 264 U.S. 1, 44 S. Ct. 232.

74. *Page v. Edmunds*, 187 U.S. 596, 23 S. Ct. 200 (1903).

75. *Board of Trade*, 264 U.S. at 7-8, 44 S. Ct. at 233.

76. *Id.* at 11, 44 S. Ct. at 234.

Therefore, the Court held that, under the Bankruptcy Act, the seat was property to which the estate was entitled.<sup>77</sup>

In *Page*, a substantially similar case, a seat on the Philadelphia stock exchange was at issue. The seat again could be sold subject to settling accounts with other members of the exchange. The Court also held that the seat was property. The Court stated that the consequences which affect the use or enjoyment of a thing reflect its value, not its inherent character as property.<sup>78</sup> Further, the Court declared that a thing having vendible value must be regarded as property, and since it could have been transferred by the debtor, it passed to the estate in bankruptcy.<sup>79</sup>

The point to be gleaned from the *Board of Trade of Chicago* and *Page* cases is that the mere fact that the property can be transferred by the debtor controls its character as property of the estate. Conditions and restrictions, such as to whom the thing may be transferred or whether certain debts must be paid for transfer to take place, are attributes which arise upon the creation of the property, and are seen as inherent traits of the property which must be observed. However, these aspects do not prevent the thing from being property of the debtor, and thus his estate.

### B. The Scope

In 1978, Congress overhauled the bankruptcy laws and enacted the new Bankruptcy Code.<sup>80</sup> In the process, old Section 70(a) was redrafted into the new Section 541(a). Under the new Code, all legal and equitable interests of the debtor in property become property of the estate upon the filing of a petition. By choosing the phrase "all . . . interests of the debtor in property," Congress intended to include a broad range of property within the estate.<sup>81</sup> The legislative history states that all kinds of property, including tangible or intangible property, causes of action, and, interestingly, all other forms of property previously specified in Section 70(a), constitute "interests of the debtor in property."<sup>82</sup> Additionally, the comments specifically recognize that a debtor's interest in property also includes record "title" to property, which is an interest, just as are possessory and leasehold interests.<sup>83</sup>

In all, though, the revision of the Bankruptcy Code in 1978 expanded on the concept of property of the estate contained in the previous Section 70(a). The use of the phrase "interest of the debtor in property," rather than "property of the

---

77. *Id.*

78. *Page*, 187 U.S. at 605, 23 S. Ct. at 203.

79. *Id.* at 602, 23 S. Ct. at 202.

80. Bankruptcy Act of 1978, Pub. Law No. 95-598, 92 Stat. 2549, now codified in 11 U.S.C. 101 (1994).

81. *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204-05, 103 S. Ct. 2309, 2313 (1983).

82. H. R. Rep. No. 95-595, at 367 (1977); S. Rep. No. 95-989, at 82 (1978).

83. *Id.*

debtor," underscores this broadened concept. The result can be summed up as this: all economic rights the debtor holds at the commencement of the bankruptcy become property of the estate under Section 541. Whether such rights become property of the estate under the Bankruptcy Code is a federal question.<sup>84</sup> However, to define the existence and extent of a debtor's right or interest, resort must be made to the underlying state law.<sup>85</sup>

## VI. INTERESTS IN PROPERTY AS DEFINED BY LOUISIANA LAW

The civil law defines a simulation as consisting of two separate, but contemporaneous agreements: one apparent and one secret.<sup>86</sup> In Louisiana, when the parties intend for the apparent act to have no effects, the simulation transfers no ownership between the parties.<sup>87</sup> However, a simulation, whether relative<sup>88</sup> or absolute,<sup>89</sup> may produce effects as to third parties.<sup>90</sup> For third persons who rely, in good faith, on the apparent act, the secret agreement has no

84. *In re Marrs-Winn Co.*, 103 F.3d 584, 591 (7th Cir. 1996); *In re Yonikus*, 996 F.2d 866, 869 (7th Cir. 1993); *In re Thomas*, 883 F.2d 991, 995 (11th Cir. 1989). See also *Chicago Bd. of Trade v. Johnson*, 264 U.S. 1, 44 S. Ct. 232 (1923) and *Page v. Edmunds*, 187 U.S. 596, 23 S. Ct. 232 (1903), where the state supreme courts in both cases had previously determined the seats on the exchanges were not property under their laws. As the court in *Board of Trade of Chicago* stated: Congress derives its power to enact a bankrupt law from the Federal Constitution, and the construction of it is a federal question. Of course, where the Bankrupt Law deals with property rights which are regulated by the state law, the federal courts in bankruptcy will follow the state courts; but when the language of Congress indicates a policy requiring a broader construction of the statute than the state decisions would give it, federal courts cannot be concluded by them.

264 U.S. at 10, 44 S. Ct. at 234 (citation omitted) (emphasis added).

85. *Butner v. United States*, 440 U.S. at 54, 99 S. Ct. at 917-918, stating:

The constitutional authority of Congress to establish "uniform Laws on the subject of Bankruptcies throughout the United States" would clearly encompass [federal property definition]. But Congress has not chosen to exercise its power to fashion any such rule. . . . Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law.

86. Marcel Planiol et George Ripert, *Civil Law Treatise*, Vol 2, Part 1, No. 1186 (La. Law Inst. Trans. 1959). There may be some confusion about the 1986 deed being a simulation since the requisite secret act (the counter letter) was apparently perfected in 1990. However, the execution of the counter letter was merely a memorialization of the agreement between the parties in 1986 that the "sale" was to have no effect.

87. La. Civ. Code art. 2026.

88. La. Civ. Code art. 2027 ("A simulation is relative when the parties intend that their contract shall produce effects between them though different from those recited in their contract. A relative simulation produces between the parties the effects they intended if all requirements for those effects have been met.")

89. La. Civ. Code art. 2026 ("A simulation is absolute when the parties intend that their contract shall produce no effects between them. That simulation, therefore can have no effects between the parties.")

90. La. Civ. Code art. 2028.

effect.<sup>91</sup> Such instances include a lender who takes a mortgage from the apparent purchaser of the immovable which was the object of the simulation, or a third party purchaser of the property from the apparent vendee.<sup>92</sup> When the secret act is made known, the lender may still assert his mortgage, and the purchaser may keep the property.

Louisiana law requires that all interests affecting immovable property be recorded.<sup>93</sup> Under the Louisiana Public Records Doctrine, a party may rely on the recorded title to the property so as to transact with the record owner of the property free of other unrecorded interests.<sup>94</sup> As the jurisprudence makes clear, "third persons dealing with immovable property have a right to depend upon the faith of the recorded title thereof and are not bound by any secret equities that may exist between their own vendor and prior owners of the land."<sup>95</sup> Regardless of the character of the previous transaction or whether one acquires an interest in the property as mortgagee, vendee, or through seizure, the principle involved in the law of registry is the same.<sup>96</sup> By relying on the public records, where the records reveal a proper sale and no counter letter, a third party to an underlying simulated sale cannot be affected by the original transferor's unrecorded interest in the property.<sup>97</sup>

Based on these principles, then, a third party may acquire a valid interest in, and even ownership of, an immovable from the record owner even though the record owner may not be the true owner.<sup>98</sup> Therefore, those transacting with the simulated vendee may obtain and record judgments, liens, mortgages, and acts of sale thereby burdening any property the purchaser apparently acquired by the simulation, without regard to the fact that the contract underlying the recorded title did not actually convey ownership to their debtor.<sup>99</sup>

---

91. Planiol et Ripert, *supra* note 86, No. 1197.

92. Saúl Litvinoff and W. Thomas Tête, *Louisiana Legal Transactions: The Civil Law of Juridical Acts* 118 (1969).

93. La. R.S. 9:2721 (Supp. 1998).

94. *McDuffie v. Walker*, 125 La. 152, 51 So. 100 (La. 1909); *Harang v. Plattsmier*, 21 La. Ann. 426 (La. 1869).

95. *Owen v. Owen*, 336 So. 2d 782, 787 (La. 1976); *Chachere v. Superior Oil Co.*, 192 La. 193, 196, 187 So. 321, 321 (La. 1939).

96. *McDuffie*, 125 La. at 167, 51 So. at 105 ("The law makes no distinction between mortgages and sales or between creditors and vendees or mortgagees . . . . Its purpose is to establish and enforce as a matter of public policy upon the subject of the most important property right with which it deals[;] the rule that unrecorded contracts affecting immovable property 'shall be utterly null and void, except between the parties thereto.'"). See also *State ex rel. Hebert v. Recorder of Mortgages*, 175 La. 94, 101, 143 So. 15, 17 (1932): The requirement of recordation thus denotes that, "there can be no actual owner of immovable property, so far as third persons are concerned, other than the owner of record."

97. *Owen*, 336 So. 2d at 787; *State ex rel. Hebert v. Recorder of Mortgages*, 175 La. 94, 143 So. 15 (1932); *Beard v. Nunn*, 133 So. 429 (La. 1931); *Jackson v. Creswell*, 147 La. 914, 86 So. 329 (La. 1920); *Vital v. Andrus*, 121 La. 221, 46 So. 217 (La. 1908).

98. *Camel v. Waller*, 526 So. 2d 1086, 1090 (La. 1988).

99. See *McDuffie*, 125 La. 152, 51 So. 100 and quoted language therein.



However, the focus of Section 541 is not on what interests third parties have in the property; rather, Section 541 is solely concerned with what interests the debtor has in the property. Recognition of the validity of third party interests, though, helps one to understand what interests a debtor may have. The fact that a third party who deals with the apparent transferee of a simulation may have his interests recognized indicates the apparent transferee held some interest in the property which he subsequently transferred to the third party.

The maxim that one may not take more from his ancestor in title than his ancestor had to give is one of the most basic and fundamental rules of property law.<sup>100</sup> Thus, it may be argued that since a third party to a simulated sale may acquire ownership where his ancestor (the apparent vendee) has none, the function of the Public Records Doctrine is the creation of interests in property. However, the purpose of the Public Records Doctrine is to protect the stability of titles.<sup>101</sup> The doctrine does not create interests in the positive sense, rather it has the negative effect of denying the effectiveness of certain rights unless they are recorded.<sup>102</sup> Therefore, one who purchases from a record title holder of the property acquires that record title. On the face of the public records, he is then the owner of the property. However, his apparent ownership is subject to the claim of the true owner (the original vendor who never actually transferred ownership to the subsequent purchaser's ancestor) to assert his actual ownership and recover the property. By requiring recordation of all interests affecting immovable property, the law denies the effectiveness of the true owner's claim to the property since it is unrecorded, and thus allows the third party to avoid the claim of the true owner.<sup>103</sup>

The purpose of the foregoing discussion is to show that the Public Records Doctrine does not create interests in the third party which did not exist in his ancestor, the apparent vendee of the simulated sale. The third party takes or receives, in whole or in part, the record title of the apparent vendee. Therefore, the apparent vendee transferred, voluntarily or involuntarily, that record title to the third person. The fact that the apparent vendee has a merchantable title,

---

100. La. Civ. Code art. 2452: "The sale of a thing belonging to another does not convey ownership."

101. *Blevins v. Manufacturers Record Publishing Co.*, 105 So. 2d 392, 414 (La. 1958) (Simon, J., on reh'g).

102. *Phillips v. Parker*, 483 So. 2d 972, 975 (La. 1986). See also *Redmann*, *supra* note 28, at 495.

103. Of course, the practical effect of allowing the third party to avoid the claim of the true owner is to basically create within the third party an ownership interest, since as to the rest of the world the third party appears as owner, and the only person who could prime his interest in the property, the true owner, is precluded from asserting his "trump card." Analytically, though, the third party is owner, still, of just the record title. True ownership rests with the true owner until actual ownership is acquisitively prescribed by the third party or his descendants in title. See La. Civ. Code arts. 3473-3491. The true owner, in theory, still owns the property, however, he is prohibited from enforcing his rights.

itself, evidences that interests in the property, as embodied in the record title, reside in the transferee of the simulated sale.

Put simply, the debtor, by recording the simulated sale, gains the right to transfer the property, in whole or in part, either voluntarily or involuntarily. The merchantability of his title actually gives the transferee several interests. As we have seen, he may sell the property. Also, he may satisfy his debts to his creditors through judicial foreclosure pursuant to a writ of fieri facias<sup>104</sup> or through a dation en paiement.<sup>105</sup> And finally, he may even exchange<sup>106</sup> the property with that of another. Therefore, the apparent transferee acquired interests in property through the simulated sale and the recordation of the act.

In *Zedda*, the debtor, Janet, gained all of these interests under Louisiana law, by virtue of the 1986 deed.<sup>107</sup> Since under state law a simulation vests in the apparent transferee interests in the property, the question thus becomes whether these are interests which the trustee may recoup through the use of his avoidance powers.

#### VII. THE CONFLUENCE OF STATE LAW PROPERTY INTERESTS AND THE BANKRUPTCY CODE

Although state law creates and defines property interests, whether such interests become property of the estate or are subject to avoidance actions is a question of federal law.<sup>108</sup> When a trustee seeks to avoid a transaction of the debtor under either Sections 547 or 548, the scope of Section 541 defines what constitutes an interest of the debtor in property, such that the trustee may avoid the transfer of that interest. The Supreme Court has stated that "property of the debtor"<sup>109</sup> . . . is best understood as that property that would have been part of the estate had it not been transferred before the commencement of bankruptcy proceedings."<sup>110</sup> The logic is simple. The fundamental policy of the Bankrupt-

---

104. See La. Code Civ. P. arts. 2291-2299.

105. La. Civ. Code art. 2655.

106. La. Civ. Code art. 2660.

107. In fact, every court implicitly recognized her record title interests. The February after Gaudet and Ferdie deeded their interests to Janet in the 1986 deed, Janet applied for and received a loan. To secure the note, she granted a conventional mortgage on the property to the bank. When the Kenilworth property was finally sold, the bank received the balance due on the note. The fact the bank was paid evidences the principle that third parties who transact with the apparent vendee receive valid interests in the property which prime the interests of the original vendor. The fact that Janet executed a valid mortgage on property she actually did not own evidences the power of her record title to the Kenilworth property.

108. See *supra* note 84 and accompanying text.

109. As noted by the *Begier* Court at 496 U.S. at 59 n.3, 110 S. Ct. at 2263 n.3, the phrase, "property of the debtor," was amended and rephrased as "interests of the debtor in property." The Court interpreted the new language as clarifying and coextensive with phrase as it is used in Section 541. Therefore, the phrase "property of the debtor," as it pertains to the quote above is equivalent with the current formulation, "interests of the debtor in property."

110. *Begier*, 496 U.S. at 58, 110 S. Ct. at 2263. Although *Begier* involved only a preferential

cy Code is equality of distribution among creditors. The purpose of avoidance provisions is to recover that property which would have been available for distribution to those creditors.<sup>111</sup> If the debtor transfers property which would not have become property of the estate had the transfer not taken place, the policies above are not implicated. As the Fifth Circuit has recognized:

[T]he primary consideration in determining if funds are property of the debtor's estate is whether the payment of those funds diminished the resources from which the debtor's creditors could have sought payment.

Conversely, if funds cannot be used to pay the debtor's creditors, then they generally are not deemed an asset of the debtor's estate . . . .<sup>112</sup>

These pronouncements mandate that when reviewing whether a transfer by the debtor was of an interest of the debtor in property, the court must hypothetically undo the transaction and determine whether the interest transferred would have become property of the estate. The key is whether the interest transferred deprived the creditors of property which would have been subject to distribution had the debtor not transferred it.

Under state law, a simulated sale vests in the apparent vendee a perfectly merchantable title to the property. The filing of a counter letter is clearly a transfer of this interest, since subsequent to the recordation of the counter letter, the apparent vendee's title is no longer merchantable.<sup>113</sup> Therefore, a court must undo the recordation of the counter letter and determine whether the property would have become property of the estate had the transfer not taken place.

Property of the estate under Section 541 includes a broad range of interests. Specifically, though, it includes property which would have become property of the estate under Section 70(a) of old 1898 Bankruptcy Act. Under the old act, the estate succeeded to any property of the debtor which he could transfer or which could be used to satisfy his debts. According to Louisiana law, recordation of an act of sale, whether it be a simulation or not, vests the vendee

---

transfer, the logic and rationale behind the quotation above applies equally to actions involving fraudulent transfers as well. See *In re Basing*, 981 F.2d 1488, 1493 (5th Cir. 1993) ("[A]n interest in property, for purposes of § 548, includes any interest of the debtor that would have been preserved for the benefit of the bankruptcy estate but for the alleged transfer.").

111. 496 U.S. at 58, 110 S. Ct. at 2263.

112. *In re Southmark Corp.*, 49 F.3d 1111, 1117 (5th Cir. 1995). See also *In re Maple Mortgage, Inc.*, 81 F.3d 592, 595 (5th Cir. 1996).

113. The word "transfer" is defined by the Bankruptcy Code as any mode conceivable of alienating or *parting with*, whether voluntary or involuntary, an interest of the debtor in property. 11 U.S.C. § 101(54) (1994). As recognized by the court in *In re Gurs*, 34 B.R. 755 (B.A.P. 9th Cir. 1983), dealing with the recordation of a *lis pendens*, an instrument having an effect similar to that of a counter letter, the concept of transfer contained in the Bankruptcy Code is sufficiently broad to encompass such a recordation. The recordation of an act of sale is, obviously, a transfer of interest as well.

with a merchantable title. The vendee may dispose of or encumber the property as he sees fit. Additionally, any of his creditors who record judgments against him obtain valid judicial mortgages on the property, in addition to the ability to seize and sell the property in satisfaction of debts owed. These interests in the property would therefore become property of the estate under the old act, and thus under Section 541 as well.

In *Zedda*, Janet's ability to alienate the property, to satisfy creditors, or otherwise implicated the policies of the Bankruptcy Code discussed above. The transfer by recordation of the counter letter clearly deprived creditors of an asset upon which they could have sought payment. Had the transfer not taken place, the property would have become property of the estate under Section 541.<sup>114</sup> Therefore, at the moment Janet recorded the counter letter, she possessed and thereby transferred an interest in the Kenilworth property.<sup>115</sup> Since the phrase "interest of the debtor in property," as it is used in Sections 547 and 548, is coextensive with the concept as it is used in Section 541, Janet's transfer is subject to avoidance by the trustee.<sup>116</sup>

### VIII. THE TRUSTEE'S STATUS AS A BONA FIDE PURCHASER

As we have seen, the Fifth Circuit erroneously placed emphasis on the Louisiana Public Records Doctrine as being embodied in the trustee's status as a bona fide purchaser. That status is entirely irrelevant to whether the debtor has an interest in property. The debtor's interests arise from the fact that, at the time

---

114. Interestingly, the Fifth Circuit explicitly concluded that had the transfer not taken place, the Kenilworth property would have become property of the estate. 103 F.3d at 1202-03 ("If this case had been one in which the record title to the [Kenilworth] Property had stood in Janet's name under a simulated cash sale deed on the day the bankruptcy petition was filed, there is no question that the Trustee would have claimed it as property of the estate under authority of §544; neither is there any question but that the bankruptcy court would have ordered the Property included in the bankrupt estate under authority of §544."). However, the trustee's status under Section 544 as a third party bona fide purchaser does not entitle him to "capture" property. As stated before, third party status under the Public Records Doctrine does not create interests, in the positive sense; it merely denies the effectiveness of unrecorded interests vis a vis the third party purchaser. The property would come into the estate by virtue of the debtor's ability to dispose of or satisfy creditors with the property, and thus, having an interest in the property as it is defined in Section 541. Thereafter, the trustee's status as a third party bona fide purchaser would allow the trustee to avoid the adverse ownership claim of the father for the return of the property.

115. It must be noted that although Section 541 is effective only at the commencement of the case, the operation of Sections 547 and 548 activates prior to the commencement of the case. Therefore, the critical moment to determine when the debtor has an interest in property is the moment of transfer. However, absent any intervening creation or deletion of an interest, the character of an interest in property remains the same from the moment of transfer to the commencement of the case. Working backward, then, if the debtor had an interest in property at the commencement of the case, and no intervening creation of that interest occurred from the transfer to the commencement, then the debtor possessed that same interest at the moment of the transfer.

116. See *supra* notes 4 and 5.

of the transfers, she was record owner of the property, not because the trustee or any other party may defeat the claim of the true owner.

According to the foregoing analysis, a transfer of those interests is avoidable, assuming the transfer meets all of the other statutory requirements. However, an avoidance of such a transfer restores only the status quo prior to the transaction. Thus, assuming the counter letter and 1990 deed were avoidable, only the debtor's interests as embodied in the record title subsist. True ownership still rests with Gaudet. Therefore, at the commencement of the bankruptcy, or the moment of the filing of the petition, record title to the Kenilworth property became property of the estate. At that moment, though, the trustee's status as a bona fide purchaser activates. Only then would the trustee's status as bona fide purchaser prime Gaudet's claim for the property as true owner since, as of the commencement of the case, his ownership interest was still unrecorded. The trustee's status would not cause the estate to acquire ownership, but merely to deny the effectiveness of the one person who could make a better claim to the property.<sup>117</sup>

#### IX. CONCLUSION

As we have seen, Congress intended to include a broad range of interests within the bankrupt estate and the ambit of the avoidance powers to effectuate a central policy of the Bankruptcy Code: equality of distribution among a debtor's creditors. The avoidance powers function to allow recovery and distribution of property which the creditors, outside of bankruptcy, could have used to satisfy their claims. Unfortunately, in *Zedda*, the court chose not to follow that policy directive and seemingly decided the case on the apparent equities of the situation: the house the father never meant to lose was on the verge of being used to satisfy the creditors of another.

*Zedda's* precedential value creates a conflict within its own circuit and with the Supreme Court that simply should not exist. So what does the trustee or court do when confronted with an avoidance analysis? Ignore *Zedda*? Follow *Zedda*? Hopefully future courts will recognize the faulty reasoning in *Zedda*. The history and policy behind the code, as well as the jurisprudence interpreting

---

117. As a final note, in *Zedda*, the issue was generally litigated as a fraudulent transfer. However, the trustee did plead the action as both a fraudulent and a preferential transfer. A fraudulent transfer requires that the property be transferred for less than reasonably equivalent value. A preferential transfer, however, merely requires that the transfer be to a preexisting creditor within the statutorily prescribed period which allows that creditor to receive more than he would have had he been relegated to a distribution in a Chapter 7 case on that debt. In this case, a preferential transfer analysis would bring about recovery of the property as well. When Gaudet originally transferred the property to Janet, by the simulated sale, a debt arose on Janet's part to reconvey the property to Gaudet. When she recorded the counter letter and 1990 deed, she was acting in fulfillment of that obligation. Therefore, Gaudet was a preexisting creditor to whom she made a transfer within the one year reach back period for transfers to insiders, which allowed him to receive more than he would have had this been a Chapter 7 case.

the code and its avoidance provisions, clearly indicates *Zedda* to be unsound. Therefore, courts confronting and analyzing avoidance problems should be careful not to fall into the *Zedda* trap.

*Brandon A. Brown*

