UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF RHODE ISLAND
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In re: :

JONATHAN ARAUJO : BK No. 00-13175
LORI ARAUJO Chapter 13
Debtors

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FINDINGS OF FACT AND CONCLUSIONS OF LAW
RE: ORDER DENYING CONFIRMATION OF DEBTORS' CHAPTER 13 PLAN

Heard on the Debtors' request for findings and conclusions regarding this Court's Order denying confirmation of his Chapter 13 plan. Upon consideration, the request is granted, and in accordance with Fed. R. Bankr. P. 7052 and 9014, here are my findings of fact and conclusions of law underlying the Order of April 12, 2001.

Findings of Fact[1]

In the summer of 1998, as agent for Jonathan and Lori Araujo who were looking to purchase a house, Sanford M. Kirshenbaum showed the Araujos several properties, and they selected one they liked. *See* Debtors' Memorandum in Support of Confirmation, Docket No. 12, page 1. Because the Araujos were unable to

[1] On November 16, 2000, at the original hearing on confirmation, the parties read stipulated facts into the record. These findings are based upon those stipulated facts, and the Debtors' own filings in this case.

obtain financing, Kirshenbaum purchased the house at 140 Vincent Avenue, North Providence, Rhode Island (hereinafter "the property") for $67,500, with the intention of subsequently transferring the property to the Araujos.[2] Kirshenbaum obtained a $54,000 mortgage in his name from Pan American Bank to finance the acquisition, and also paid the balance of the purchase price, $13,500, personally. As anticipated, on August 12, 1998, the day after the closing, the Araujos moved into the property. On March 11, 1999, when Kirshenbaum conveyed the property to the Araujos, it was subject to the Pan American/Fidelity Mortgage.[3] Thereafter, on April 7, 1999, the Araujos executed a promissory note in favor of Marlene Hope, Inc. in the amount of $25,245, which was secured by a second mortgage on the property.[4] Marlene

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[2] This arrangement constituted a mutually beneficial joint venture between the parties, i.e., (1) to secure for Kirshenbaum a profit; and (2) to enable the Araujos to own a home, despite their lack of creditworthiness.

[3] The mortgage obtained from Pan American Bank was subsequently assigned to First Fidelity Federal Bank ("Fidelity").

[4] While not specifically set out in the stipulated facts nor germane to this dispute, it appears that the Real Estate was first transferred to Marlene Hope, Inc., and then to the Araujos. Marlene Hope, Inc. took back this second mortgage for the initial down payment paid by Sanford Kirshenbaum, and for Kirshenbaum's broker's fee.

Hope is the daughter of Sanford Kirshenbaum and the sole shareholder of Marlene Hope, Inc.

The conveyance to the Araujos triggered the due on sale clause in the Pan American/Fidelity Mortgage, and on January 1, 2000, Fidelity made demand for payment in full from Kirshenbaum. In June 2000, Kirshenbaum paid Fidelity $45,000, in July he paid an additional $4,000, and on August 23, 2000, he paid the remaining balance, $4,460, and requested in writing that Fidelity issue him an assignment of the mortgage, rather than a discharge. Three weeks later, when the Araujos filed a joint Chapter 13 petition, the Fidelity mortgage had not been either released or discharged. On October 10, 2000, a mortgage discharge was recorded by Fidelity in the North Providence land evidence records, clearly in error and without Kirshenbaum's consent. At all relevant times throughout these proceedings the Debtors had actual knowledge of the Pan American/Fidelity mortgage.

Under their Chapter 13 plan, the Debtors propose to pay the balance due Fidelity on the date of filing ($2,000), and the secured claim of Marlene Hope, Inc., over the life of the plan, in full. Sanford Kirshenbaum, who paid $67,500 to purchase the property for the Araujos, is scheduled to receive nothing. The

Debtors point out that under 11 U.S.C. § 544(a)(3), the trustee (and the debtor in a Chapter 13 context) has the rights of a bonafide purchaser for value ("BFP") with respect to real estate, and holds the property free of all unrecorded interests and equitable liens.

They ignore, however, a threshold problem with their alleged BFP status, i.e., *their actual knowledge*[5] of and active participation throughout the process which enabled them to become the record owners of the property.

They also overlook a fundamental purpose of the recording statutes – under Rhode Island law, "[a] recording or filing under § 34-13-1 shall be constructive notice to all persons of the contents of instruments and other matters so recorded, so far as they are genuine." R.I. Gen. Laws § 34-13-2, and that "[t]he purpose of constructive notice is to bind subsequent purchasers and all other affected parties by restrictions that are clearly set forth in prior conveyances or other instruments appropriately recorded." *Speedy Muffler King, Inc. v. Flanders*, 480 A.2d 413, 415 n.1 (R.I. 1984). A recorded instrument

[5] In a case like this the Debtors' actual knowledge would be imputed to the Trustee, if (s)he were advocating the Debtors' position.

provides constructive notice of its contents and all legal incidents thereto. *See Chase v. Mortgage Guarantee & Title Co.*, 158 A. 724, 726 (R.I. 1932). *Chase* involved an action in tort against a title examiner who failed to reveal as part of his examination the amount due to the first mortgagee for taxes, interest, and insurance. Finding no negligence on the part of the examiner, the Court held that the second mortgagee, who had constructive knowledge of the first mortgage, was "charged with the payment of the senior mortgage debt. ... If interest is not stipulated for in the mortgage deed, it is an invariable legal incident of the principal debt... ." *Id*.

But this discussion about constructive notice is really superfluous, because of the Araujos' actual knowledge of the Fidelity mortgage, and also because of their active participation in the plan that Sanford Kirshenbaum should take the mortgage in his name, specifically to enable them to become the owners of the property. In the circumstances, the ambush they propose is quite bewildering.

Under Rhode Island law, Kirshenbaum was entitled to an assignment of the mortgage, and in fact, he duly requested an assignment, rather than a discharge. *See* R.I. Gen. Laws § 34-

26-4.[6] That right is a valid legal incident of the mortgage, and because Fidelity erroneously issued a discharge that was mistakenly recorded after the commencement of the bankruptcy proceeding should not enure to the Debtors' benefit.[7]

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[6] The statute states:

> Requiring assignment of mortgage in lieu of discharge -- Enforcement by incumbrancers.
> Where a mortgagor is entitled to redeem, he or she shall by virtue of this section have power to require the mortgagee, instead of discharging or reconveying, and on the terms on which he or she would be bound to discharge or reconvey, to assign the mortgage debt and convey the mortgaged property to such third person as the mortgagor directs...

R.I. Gen. Laws § 34-26-4.

[7] The facts of this case absolutely disqualify the Araujos as bonafide purchasers. In Rhode Island "a person who acquires a legal title or an equitable title or interest in a given subject-matter, even for a valuable consideration, but with notice that the subject-matter is already affected by an equity or equitable claim in favor of another, takes it subject to that equity or equitable claim." ***Howard v. McPhail***, 37 R.I. 21, 28 (R.I. 1914)(citation omitted); and although not asserted, it is quite arguable that the Araujos' actions, if premeditated, are fraudulent and sanctionable. In ***McPhail***, the Court said: "The taking of a legal estate after notice of a prior right makes a person a ***mala fide*** purchaser. ***Le Neve v. Le Neve***, 2 White & T. Lead. Cas. Eq. (4th Am. Ed.) 109. Undoubtedly, it is an act savoring of fraud for a person who has received actual direct notice of another's right to go on, and knowingly acquire the property in violation of that other's right." ***McPhail*** at 30 (quoting Jones Ch. Mort. (5th ed.) p. 699, § 484). This venerable case (***McPhail***) still appears to represent the law in this State, and is relevant in this case.

The Rhode Island Supreme Court has stated "that a technical deficiency that would be subject to reformation in equity ought not to create a windfall for ... those who would become bona fide purchasers," *In re Barnacle*, 623 A.2d 445, 449 (R.I. 1993), and a long time ago the Supreme Court also held that "a man[/woman] [cannot] stand by and see another part with his money upon the faith of a conveyance, and then, taking advantage of some defect known to him, claim that, under a subsequent conveyance, he has acquired a title superior in equity to that of the first purchaser." *Bullock v. Whipp*, 15 R.I. 195, 197 (1885). Because of the Araujos' knowledge of the mortgage, and that Sanford Kirshenbaum was advancing funds with the intent of stepping into Fidelity's shoes, they are estopped from taking the position announced in their plan, and their interest in the property remains subject to the Fidelity mortgage and any assignment of that mortgage to Kirshenbaum.

Finally, the Chapter 13 Trustee's unjust enrichment argument is also well taken. Rhode Island Superior Court Judge Michael Silverstein has recently discussed the subject at length:

> The doctrine of unjust enrichment "permits the recovery in certain instances where a person has received from another a benefit, the retention of which, would be unjust under some legal principle, a situation which equity has established or recognized."

> *Merchants Mutual Insurance Co. v. Newport Hospital*, 108 R.I. 86, 93, 272 A.2d 329, 332 (1971). "[T]he unjust enrichment doctrine has for its basis that in a given situation it is contrary to equity)and good conscience for one to retain a benefit that has come to him [or her] at the expense of another and that it is not necessary in order to create the obligation to make restitution or to compensate that the party unjustly enriched be guilty of a tortious or fraudulent act." *Id*. In Rhode Island, "actions brought upon theories of unjust enrichment and quasi-contract are essentially the same." *Bouchard v. Price*, 694 A.2d 670, 673 (R.I. 1997) (*quoting R & B Electric Co. v. Amco Construction Co.*, 471 A.2d 1351, 1355 (R.I. 1984). It is well-settled that "in order to recover under quasi-contract for unjust enrichment, a plaintiff is required to prove three elements: (1) a benefit must be conferred upon the defendant by the plaintiff, (2) there must be appreciation by the defendant of such benefit, and (3) there must be an acceptance of such benefit in such circumstances that it would be inequitable for a defendant to retain the benefit without paying the value thereof." *Id.* (citations omitted).
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> Under the doctrine of unjust enrichment, the concept of benefit is construed broadly: "a person confers a benefit upon another if he [or she] ... satisfies a debt or a duty of the other, or in any way adds to the other's security or advantage. He [or she] confers a benefit not only where he [or she] adds to the property of another, but also where he [or she] saves the other from expense or loss. The word 'benefit,' therefore, denotes any form of advantage."
> Restatement of Restitution § 1, cmt. b at 12 (1937).

State v. Lead Industries Ass'n, Inc., 2001 WL 345830 *14-15 (R.I. Super. Ct. April 2, 2001). Clearly, from any perspective, the Araujos would be unjustly enriched by at least $53,460, the amount paid by Sanford Kirshenbaum to Fidelity to satisfy the

first mortgage on the Araujos' home, if their plan were confirmed as proposed.

For the foregoing reasons, and because any other result would violate basic principles of both law and equity, confirmation of the Debtors' Chapter 13 plan is DENIED.

Dated at Providence, Rhode Island, this 9th day of October, 2001.

/s/ Arthur N. Votolato
Arthur N. Votolato
U.S. Bankruptcy Judge