REAL ESTATE LAW: ADVANCED ISSUES AND ANSWERS

Originally Presented August 19, 2012

LIENS ON REAL PROPERTY

AND

CREDIT AND BANKRUPTCY ISSUES

by Matthew M. Boley[1]

[1] This article is provided for informational purposes only. It is not intended as, and does not constitute, legal advice. Further, access to or receipt of this article by any recipient shall not be construed to create an attorney-client relationship. Finally, the author disclaims any and all representations or warranties, express or implied. Among other things, recipients of this article hereby are warned and notified that the information provided herein may be incorrect and/or incomplete. As such, it is not reasonable for any person to rely upon this article or the information provided herein. Rather, all persons who obtain or review this article are encouraged to retain a licensed attorney to provide him, her or it with individualized and current legal advice.

Copyright © 2012 Matthew M. Boley
All rights reserved

III. LIENS ON REAL PROPERTY

A. Ad Valorem Property Tax Liens

Property tax liens attach automatically to all real property. The lien automatically primes all other liens, whether consensual or not.

If a real property tax lien remains unpaid after five years, the property is subject to a tax sale to satisfy the lien. The property may be "redeemed" from the tax sale up until the moment that the sale occurs. Once the sale occurs, however, the sale is final and the property can no longer be "redeemed."

Generally, property sold at a tax sale will be the smallest portion necessary to bring a bid that pays in full the tax due.

B. Federal Tax Liens

1. Tax Liens Generally

When a federal tax is "assessed" a general federal tax lien arises automatically and attaches to all of the taxpayer's property. See 26 U.S.C. § 6321.

By filing a notice of tax lien, the Internal Revenue Service protects itself against later claims and subsequent liens. When this occurs, the federal tax lien is "perfected" as against subsequent lienors, purchasers and claimants.

The federal statute permits each State to prescribe the "office within the State" in which the notice of tax lien must be filed. Utah has designated "the office of the county recorder of the county within which any property subject to the lien is situated" as the office in which a notice of federal tax lien must be filed or "perfected." Utah Code Ann. § 38-6-1.

However, unless and until a "notice of lien" is "filed" pursuant to section 6323(f) of the Internal Revenue Code and in the manner prescribed by state law, the federal tax lien is not valid against (a) holders of liens or security interests in the taxpayer's property, (b) purchasers of the taxpayer's property, (c) judgment lien creditors, or (d) mechanic's lienors. See 26 U.S.C. § 6323(a). Such persons are protected against the "unperfected" tax lien even if he or she had actual knowledge of the tax lien.

Copyright © 2012 Matthew M. Boley
All rights reserved

Once a mortgage is recorded or judgment lien is perfected according to state law, an inferior tax lien will remain inferior, even after notice of the federal tax lien is filed.

Certain types of revolving collateral, however, are subject to the so-called "45-day rule." In such cases, a properly perfected security interest in accounts or inventory will prime the federal tax lien for 45 days after the notice of lien is filed. Any accounts arising or inventory purchased on or after the 46th day, however, will be subject first to the federal tax lien. Likewise, advances on or after the 46th day even on existing collateral will be primed by the federal tax lien.

2. *Estate Tax Liens and Transferee Liability*

Pursuant to section 6324(a)(1) of the Internal Revenue Code, when there exists a balance due on an estate tax liability, a lien automatically and without notice arises at the time of death against all property included in the decedent's estate. That lien has a duration of ten years from the date of death.

In addition to the special estate tax lien, section 6324(a)(2) of the Internal Revenue Code imposes personal liability for the unpaid estate tax against, inter alia, a "beneficiary who receives...property included in the gross estate … to the extent of the value, at the time of the decedents death, of such property...."

In other words, all property included within a decedent's estate are subject to the estate tax lien. When any of that property is transferred to a "beneficiary," such person becomes personally liable for a portion of the unpaid estate tax equal to the value inherited or otherwise transferred.

If the beneficiary thereafter transfers or pledges as collateral for the loan the property that was subject to the federal tax lien, then the lien is extinguished as to the property transferred or pledged, but a new lien then arises and attaches to all of the property of the beneficiary. See 26 U.S.C. § 6324(a)(2) ("Any part of such property transferred by ... such ... beneficiary ... to a purchaser or holder of a security interest shall be divested of the lien provided in paragraph (1) and a like lien shall then attach to all the property of such ... beneficiary ... except any part transferred to a purchaser or a holder of a security interest."

Copyright © 2012 Matthew M. Boley
All rights reserved

C. Judgment Liens

Judgment liens can be a powerful collection tool. Often, however, patience is the greatest virtue in the effective use of judgment liens.

A certified copy of a judgment (or abstract of judgment) recorded together with a so-called "judgment information statement" constitutes a lien upon "all the real property of the judgment debtor: (i) in the county in which the recording … occurs; and (ii) owned or acquired at any time by the judgment debtor during the time the judgment is effective." Utah Code Ann. § 78B-5-202(7)(c).

The judgment lien shall be effective for "eight years from the date of entry in a court …." After the eight years runs, the judgment lien will no longer be effective. The judgment creditor may obtain a renewed judgment to continue in effect the judgment. At that time, however, the judgment creditor must record the new judgment and the priority date of the judgment lien restarts, *i.e.*, it does not relate back.

The proper method to foreclose a judgment lien is a writ of execution followed by a sheriff's sale. Such a sale, however, is subject to the judgment debtor's homestead exemption.

The most significant exemption available under Utah law is the so-called "homestead exemption." An individual may claim a "homestead exemption" in the amount of $20,000 in his or her primary personal residence, or in the amount of $5,000 in real property which is not the person's primary personal residence. See Utah Code Ann. § 78B-5-503(2)(a). If the property is jointly owned, for example, by a husband and wife, the amount of the exemption is doubled to "40,000 per household" in the primary personal residence and "$10,000 per household" in all other real property. See Utah Code Ann. § 78B-5-503(2)(c).

"[A]n individual may select and claim a homestead" by filing a signed and acknowledged declaration of homestead with the county recorder in which the homestead property is located, or by serving a signed and acknowledged declaration of homestead upon the sheriff or other officer conducting an execution sale prior to commencement of the sale. See Utah Code Ann. § 78B-5-504.

Copyright © 2012 Matthew M. Boley
All rights reserved

Effectively, the homestead exemption prevents the judgment creditor from making a credit-only-bid for the property subject to the judgment lien. Instead, the judgment creditor must cash bid the amount of the homestead exemption and may credit bid only after the homestead amount is paid. This debtor protection is powerful enough that sheriff sales of homestead property are very rare.

D. Mortgages, Trust Deeds and Other Consensual Liens

Security interests are rights created by contract or statute to realize on specific property to satisfy a debt or other obligation. There may be more than one which applies to any parcel of property, and their priority is generally governed by the recording act Utah Code Ann. §§ 57-3-101 et seq., 57-4a-1 et seq., subject to some special priority rules for such things as mechanics liens and tax liens. See, e.g., Utah Code Ann. §§ 38-1-1 et seq. (mechanic's liens); Utah Code Ann. §§ 38-6-1 et seq. and 26 U.S.C. § 6320 et seq. (federal tax liens); Utah Code Ann. § 59-1-302.1 (Utah state tax liens).

Consensual liens upon real property generally fall within known types of interests. Occasionally, however, the courts have to construe some strange things created by parties, which may give rise to equitable mortgages. See Nagle v. Club Fontainbleu, 405 P.2d 346 (Utah 1965) (an instrument deemed to be a mortgage); Bybee v. Stuart, 189 P.2d 118 (Utah 1948); Thornley Land & Livestock Co. v. Gailey, 143 P.2d 283 (Utah 1943) (a deed absolute may be a mortgage if presumption that deed is what it purports to be is overcome by proof that is "clear, definite, unequivocal, and conclusive").

The three types of instruments generally used to take a lien or security interest in real property are mortgages, deeds of trust and installment land purchase contracts a/k/a uniform real estate contracts.

1. Mortgages

A mortgage is an instrument under which the "mortgagor" grants a lien – an equitable remedy to obtain the mortgaged realty – to the "mortgagee" to satisfy a specific debt identified in the mortgage. Mortgages are generally covered by Utah Code Ann. §§ 57-1-14 and -15, 57-1-38 through -44, 78B-6-901 (formerly 78-37-1) et seq., and Utah Rules of Civil Procedure 69B and 69C.

Copyright © 2012 Matthew M. Boley
All rights reserved

A mortgage is not a true interest in land, but is a grant of an equitable remedy, and as such, is subject to a certain amount of court discretion. See Dugan v. Jones, 615 P.2d 239 (Utah 1980). Mortgages usually secure promissory notes, but just about any obligation can be secured by one. Mortgages often are used in loan transactions and seller-financed sales of real estate. The mortgaged property can be sold at a judicially-ordered sheriff's sale. Judicial foreclosure is the only means for foreclosing upon real property subject to a mortgage.

2. Deeds of Trust

Deeds of trusts are statutorily recognized and regulated. See Utah Code Ann. §§ 57-1-19 through -44, and 78B-6-901(1) (formerly 78-37-1). A trust deed conveys legal title from the "trustor" to a "trustee," who holds that title in trust for the "beneficiary." The grant is equitable in nature and subject to a certain amount of court discretion. Trust deeds usually secure the trustor's obligations under a promissory note, but just about any obligation may be secured by one. Trust deeds often are used in loan transactions and seller-financed sales of real estate, and are by far the most commonly used of the typical security devices.

The trust deed and the applicable statutes permit non-judicial foreclosure, pursuant to which the trustee holds the power to sell the trust property to satisfy the obligation. The beneficiary (lender) also may elect to foreclose a deed of trust judicially, like a mortgage.

3. Uniform Real Estate Contracts/Installment Land Sale Contract

Uniform Real Estate Contracts (URECs) are a standard version of an installment land sale contract. Such contracts deliver possession to the purchaser and pass "equitable title." Legal title, however, remains in the seller, subject to delivery of a deed upon full payment of the purchase price.

URECs and other installment land sale contracts are used exclusively in seller-financed sales of real property – usually residential property with low down payments where other financing is difficult or impossible to obtain. Under case law that has developed in Utah, the doctrine of "equitable conversion," recognizes the buyer-debtor as

Copyright © 2012 Matthew M. Boley
All rights reserved

the equitable owner of the property under such a contract. See Capital Assets Financial Services v. Maxwell, 994 P.2d 201 (Utah 2000); Cannibal v. Clement, 818 P.2d 546 (Utah 1991) (seller's interest is personal property for judgment lien purposes); Butler v. Wilkinson, 740 P.2d 1244 (Utah 1987) (judgment lien attaches to contract buyer's interest).

Both earnest money agreements and installment land sale contracts give rise to the doctrine of "equitable conversion." The vendor (or seller) retains legal title under both types of contracts. In the case of an installment land sale contract, however, "the vendor retains legal title *as security* for the purchase price of the property." Butler v. Wilkinson, 740 P.2d 1244, 1254 (Utah 1987) (emphasis added). "The vendor's interest is similar to the *security interest* of a purchase money mortgagee." Id. at 1255 (emphasis added). In short, Utah law treats an installment land sale contract as a *disguised mortgage*. See, e.g., Perkins v. Spencer, 243 P.2d 446, 450-51 (Utah 1952) (holding forfeiture provision under Uniform Real Estate Contract unenforceable).

The remedies ostensibly available under an installment land sale contract include (a) forfeiture of payments and eviction, (b) foreclosure as a mortgage, or (c) suit to collect the unpaid installments. Sometimes such contracts also purport to grant a trust deed-like power of sale option. It should be noted, however, that Utah courts have been loathe to enforce the forfeiture provisions under such contracts.

4. The One Action Rule

Utah, modeling its law after a California statute, has enacted the so-called "one action rule." See Utah Code Ann. § 78B-6-901. The statute provides, in pertinent part, that "[t]here is only one action for the recovery of any debt or the enforcement of any right secured solely by mortgage upon real estate …." While the statute is specific to mortgages, it is generally recognized that the one-action rule applies to trust deeds as well. See City Consumer Servs., Inc. v. Peters, 815 P.2d 234, 236 (Utah 1991) (so holding).

"[T]he effect of the one-action rule is to limit a creditor's means of enforcing its debt but not the right to recover …." Id. In other words, the rule dictates the procedure

Copyright © 2012 Matthew M. Boley
All rights reserved

by which a creditor may collect a debt secured by realty. See id. at 235 ("The rule … essentially dictates the procedure by which a creditor may collect a debt in the case of a debtor's default."); APS v. Briggs, 927 P.2d 670, 673 (Utah Ct. App. 1996) ("The purpose of the one-action rule is to regulate the procedure of recovery of a secured creditor, not to deny the creditor's contract right to recover on its loan.") (citations omitted). The one-action rule implements a "security first" approach, whereby the secured creditor must first exhaust its real property security interest before suing the debtor personally. See In re property located at 2793 South 3095 West, West Valley City, Utah 84119, 2000 UT App. 116 ¶ 7, 1 P.3d 1116, 1118 ("Under the one-action rule, the creditor must rely upon his security before [otherwise] enforcing the debt.") (citations omitted). The only exception to this rule is where the secured creditor chooses to foreclose its mortgage or trust deed *judicially*, in which case the lender may assert both a claim for judicial foreclosure and a claim for a personal judgment, both in the "one-action."

Generally, the result of bringing suit in violation of the one-action rule is that the action will be dismissed. This is because, under Utah law "there is no personal liability on the part of the mortgagor until after foreclosure or sale of the security and then only for the deficiency then remaining unpaid; a mortgagee may not have a personal judgment against the mortgagor until the security has first been exhausted." National Loan Investors, L.P. v. Givens, 952 P.2d 1067, 1071 (Utah 1998) (citations omitted). This reasoning, which consistently has been followed and restated since at least 1936, seems to suggest that the only adverse consequence that a creditor might face in bringing suit in contravention of the one-action rule is the risk that its suit will be dismissed without prejudice, and that it might be ordered to pay the defendant's attorney fees.

Utah's courts have never addressed whether dismissal is the only possible consequence of filing suit in violation of the rule. Other jurisdictions, however, have ruled that if the debtor fails to raise the rule as an affirmative defense and the lender obtains a personal judgment, the judgment might have the effect of waiving and releasing the lender's real property security interest. See Walker v. Community Bank, 518 P.2d

Copyright © 2012 Matthew M. Boley
All rights reserved

329, 332 (Cal. 1974). Until either Utah's courts or its legislature announce whether Utah's one-action rule is susceptible of this application, any risk of such a draconian sanction is probably too high, especially when a lender need only wait the four to five months necessary to complete a non-judicial foreclosure before bringing suit, and thereby avoid the risk altogether.

5. Judicial Foreclosure

A mortgage must be foreclosed judicially, *to wit*, by a judgment of the court at the conclusion of a lawsuit. Utah Code Ann. §§ 78B-6-1310 (formerly 78-40-8) and 78B-6-901 through -908 (formerly 78-37-1 through -9). A deed of trust may, but is not required to be, foreclosed judicially.

In a judicial foreclosure action, the court is asked to determine the rights and priorities in the property and to "foreclose" interests junior in priority to the mortgage. The foreclosure, however, may not be used oppressively, and equitable defenses may be available to a mortgagor. See U. S. v. Loosley, 551 P.2d 506 (Utah 1976). If a lender is able to meet its burden of proof regarding the amount of the debt and the validity of the mortgage lien, the court will issue a judgment and a decree of foreclosure. The amount due to the lender is determined and declared, and the Sheriff is directed to sell the mortgaged property at a public sale.

Suit must be filed against the mortgagor, its successors in interest, and against all persons claiming an interest in the property, particularly those with junior interests who will lose them in the foreclosure. See Dumont Corp. v. Arrington, 457 P.2d 616 (Utah 1969) (tests for necessary parties to foreclosure); Utah Code Ann. § 78B-6-903 (formerly 78-37-3) (unrecorded interest not a necessary party); Gigliotti v. Albergo, 115 P.2d 791 (Utah 1941) (same). Endorsers, guarantors, lessees, etc., may be joined. The holders of senior liens and interests generally are not joined unless a determination as to priority is needed. Under 28 U.S.C. § 2410, the United States may be named a party in a foreclosure where it may have a claim on the property. Mortgage Electronic Registration Systems, Inc. (MERS), which takes title in mortgages to enable their easier securitization or transfer, arguably may be a necessary party to a foreclosure. See Landmark National

Copyright © 2012 Matthew M. Boley
All rights reserved

Bank v. Kesler, 192 P.3d 177 (Kan. App. 2008) (MERS is only an agent or nominee, and is mortgagee in name only, and is not a necessary party; originator of mortgage was named in the foreclosure and defaulted, and the transferee of the mortgage could not set aside the foreclosure).

After judgment, the mortgaged property is sold via public auction, conducted by the sheriff after posting the notice of sale at the place of sale, the property, the courthouse in the county or city where the property is located, and at three other public places in that county or city, for at least 21 days before the sale, and after advertising the notice of sale in a newspaper of general circulation in the county once a week for three consecutive weeks immediately prior to sale. See Utah Rule Civil Procedure 69B(b)(3). A sale may be postponed for up to 72 hours without renoticing the sale. The sale will be held at the courthouse between 9 a.m. and 8 p.m. Monday through Saturday. The sheriff issues a certificate of sale to the highest bidder on payment of the price. Utah Rule Civil Procedure 69B(i).

If the amount of the successful bid is not equal to the judgment, a deficiency automatically will be entered as a judgment against the borrower and any guarantors. Thereafter, the judgment creditor may then levy against any nonexempt property of the judgment-debtor. Thus, be foreclosing judicially, a creditor can avoid the significant expense and delay incidental to deficiency litigation applicable in the case of non-judicial foreclosure.

The protection to a borrower/guarantor in a judicial foreclosure scenario is the "right of redemption." Within 180 days after the sale, the mortgagor or any foreclosed junior interest may "redeem" the property by paying the amount of the bid, plus six per cent (not a per-annum amount) for an initial redemption (and six percent on costs paid after sale by the sale purchaser where notice of them is filed with the court, such as taxes, assessments, insurance, maintenance, repair, and other liens, as to an initial redemption). Subsequent redemptions are at the prior redemption price plus three percent. Each redemption is described in a certificate of redemption provided by the prior purchaser. If the defendant (mortgagor) is the redemptioner, it is returned to its estate notwithstanding

Copyright © 2012 Matthew M. Boley
All rights reserved

the sale, and there are no further redemptions. The mortgagor's and other persons' right of redemption is provided by Utah Code Ann. §§ 78B-6-906 (formerly 78-37-6) and Utah Rule of Civil Procedure 69C.

The last redemptioner receives conveyance of the land by sheriff's deed. If there is no redemption, the sheriff will issue a sheriff's deed to the successful bidder. The sheriff's deed establishes a new title in the property.

The purchaser (or, if applicable, the redemptioner) has the right to possession and rents until a subsequent redemption, but rents are a credit against the redemption price. The right of possession and to rents is subject to a superior claim. The purchaser or redemptioner may be required to account for the rents and the redemption period may be extended until the accounting is delivered. Utah R. Civ. Pro. 69C(i)(2).

The United States has a separate federal right to notice and right of redemption where it has a tax lien or other interest. See 26 U.S.C. § 7425. If not named a party and if the notice and redemption process is not used, the filed tax lien remains effective despite foreclosure.

6. Non-Judicial Foreclosure, i.e., Trustee's Sale

A lender who desires to foreclose upon real property pledged under a deed of trust can proceed with a judicial foreclosure pursuant to Utah Code Ann. § 78-37-1 *et seq*., or may foreclose through a non-judicial "trustee's sale" pursuant to the Utah Trust Deed Act, Utah Code Ann. § 57-1-19 *et seq*.

If a lender opts for non-judicial foreclosure, it should be aware that Utah law (a) bars any deficiency claim not filed within three months after the trustee's sale of real property collateral and (b) limits the potential amount of the deficiency judgment to the amount by which the debt, on the date of the sale, exceeded the "fair market value" of the property sold at trustee's sale. See Utah Code Ann. § 57-1-32.

a. Trustee

Under a deed of trust, title to the property is held in trust by the "trustee" as collateral or security for payment or performance of the obligations secured. When a

Copyright © 2012 Matthew M. Boley Last Updated Aug. 19, 2012
All rights reserved

trust deed is foreclosed non-judicially, all notices, processes and procedures must be performed, given or done by the trustee or his attorneys.

A trustee under a trust deed must be a bank or savings and loan, a licensed attorney, a title company, a trust company, or certain government agencies. Only a depository institution, trust company, or specified government agency may act as the trustee at the same time that it is the a beneficiary. In order to conduct a trustee's sale (*i.e.*, the public auction that culminates a non-judicial foreclosure), however, the trustee must be a Utah attorney with an office in Utah or a Utah title company or agency with an office in Utah. See Utah Code Ann. § 57-1-21(3). Thus, an attorney or title company may need to be substituted as trustee in case of a default.

The trustee acts as the fiduciary of both parties in a very limited sense. "The duty of the trustee under a trust deed is greater than the mere obligation to sell the pledged property in accordance with the default provision of the trust deed instrument, it is a duty to treat the trustor fairly and in accordance with a high punctilio of honor." See, e.g., Blodgett v. Martsch, 590 P.2d 298, 302 (Utah 1978). Further, a trustee has a duty "to act with reasonable diligence and good faith on [the trustor's] behalf consistent with [the trustee's] primary obligation to assure payment of the secured debt." Id. at 303.

b. The Foreclosure Process

i. The Notice of Default

After the trustor defaults on the secured obligation, the beneficiary may request the trustee to exercise the power of sale. Upon receiving such instructions, the trustee commences a non-judicial foreclosure by "recording" a Notice of Default. See Utah Code Ann. § 57-1-24(1). Within ten days after recording, a copy of the recorded notice must be mailed to the trustor and to all other parties who have filed a request for notice by the time the notice of default is filed. The trustee normally obtains a title report to determine to whom notices should be sent.

ii. Request for Notice

A request for notice of default or of sale may be contained in the trust deed itself as to parties to the trust deed. Otherwise, it is a separate document (not included in any

Copyright © 2012 Matthew M. Boley
All rights reserved

other recorded instrument) filed of record after the trust deed and before the notice of default, in compliance with a specific statutory procedure. See Utah Code Ann. § 57-1-26(1). Junior creditors and subordinate interest holder should record a request for notice to ensure that he or she receives any foreclosure notices relating to the property. Otherwise, the trustee is authorized to ignore them in the notice requirements leading to sale. See Utah Code Ann. § 57-1-26(1)(f). To prevent due process challenges and/or to improve bidding at sale, however, a trustee often voluntarily sends notice to all known parties of record.

iii. Statutory Right of Reinstatement

The trustor and all junior lienholder have the statutory right to cure the default and reinstate the obligation even if the note has been accelerated. See Utah Code Ann. § 57-1-31(1). This right lasts for three months after the recording of the notice of default. See id. This statute departs from the general rule that, once a valid acceleration occurs, the debtor generally must pay the entire amount to avoid foreclosure or other remedies. See Johnston v. Austin, 748 P.2d 1084 (Utah 1988).

Payment of the "the entire amount then due [but for acceleration] under the terms of the trust deed (including costs and expenses actually incurred in enforcing the terms of the obligation, or trust deed, and the trustee's and attorney's fees actually incurred)," including a reasonable fee for cancellation, has the effect of decelerating the obligation and reinstating it as if no default or acceleration had occurred. Utah Code Ann. § 57-1-31(1); see also id. § 57-1-33(2). If the default is so cured, the trustee must execute and deliver a "cancellation of notice of default." Id.

iv. Pre-Foreclosure Right of Redemption

The trustor and/or junior lienholder also may "redeem" the property at any time prior to the sale by paying the full amount of the debt, including the full accelerated balance and all fees and expenses. If the trust deed is so redeemed, the beneficiary is required to "reconvey" the trust property to the trustor and/or the persons entitled thereto.

Copyright © 2012 Matthew M. Boley
All rights reserved

v. Notice of Sale

After three months from the date of recording the notice of default, the trustee may give notice of sale. The notice must be in substantially in a form prescribed by statute. See Utah Code Ann. § 57-1-25(3). The notice of sale is given by publication, posting and mailing.

Notice must be published once a week for at least three consecutive weeks in a newspaper of general circulation in the county, with the last publication at least 10, but not more than 30, days before the scheduled date for sale. See Utah Code Ann. § 57-1-25(1)(a)(i). Notice also must be published "on a website established by the collective efforts of Utah's newspapers. See Utah Code Ann. §§ 45-1-101(2)(b) and 57-1-25(1)(a)(i).

Notice of the trustee's sale must be posted both (a) in some conspicuous place on the property, and (b) in the county recorder's office for at least 20 days before the scheduled sale. See Utah Code Ann. § 57-1-25(1)(b).

Finally, notice of the trustee's sale must be mailed to the trustor(a) and anyone else who filed a request for notice prior to the date of recording of the notice of default. This notice must be mailed at least 20 days before the date of sale by certified or registered mail, return receipt requested. See Utah Code Ann. § 57-1-26(2)(b).

vi. The Trustee's Sale

The trustee's sale must be held at a courthouse serving the county in which the property to be sold, or some part of the property, is located. See Utah Code Ann. § 57-1-25(2)(c). The sale also must be conducted between the hours of 8 a.m. and 5 p.m. See Utah Code Ann. § 57-1-25(2)(b). The statute is silent regarding whether the sale may be held on a weekend or holiday.

The trustee may postpone the sale by giving a notice of postponement at the time and place last scheduled for the sale, either in writing or orally. See Utah Code Ann. § 57-1-27(2). If the time of postponement is greater than 45 days in the aggregate, the trustee must repeat the process for giving notice of sale. See id.

Copyright © 2012 Matthew M. Boley Last Updated Aug. 19, 2012
All rights reserved

At the sale, the trustee must sell property "at public auction to the highest bidder." The trustee may bid for the beneficiary under the trust deed, *i.e.*, the lender. Further, the beneficiary or lender may "credit bid" an amount "not to exceed" its debt as defined and circumscribed by Utah Code Ann. § 57-1-28(1)(b).

Each bid made at the sale is considered an irrevocable offer. Indeed, pursuant to Utah Code Ann. § 57-1-27(1)(b), "[a] bidder refusing to pay the bid price "is liable for any loss occasioned by the refusal including interest, costs, and trustee's and reasonable attorneys' fees." If the highest bidder refuses to pay the amount bid, the trustee also is required, at his election, either (a) to renotice the sale, or (b) to sell the property to the next highest bidder.

vii. The Trustee's Deed; No Right of Redemption

Within three business days of payment, the trustee must deliver his "trustee's deed" to the successful bidder. The deed is without any right of redemption by the trustor or junior lienors. Normally, it also is without any warranties. Further, by statute, the "trustee's deed shall be considered effective and relate back to the time of sale." Utah Code Ann. § 57-1-28(3).

The trustee's deed may recite its compliance with the notice and other procedural requirements of the statute. If it does, these recitals "constitute prima facie evidence of compliance" and "are conclusive evidence in favor of bona fide purchasers and encumbrancers for value and without notice." concerning the foreclosure process which will be conclusive as to bona fide purchasers for value and without notice. Utah Code Ann. § 57-1-28(2)(c).

ix. Deficiency Liability

At any time within three months after the sale, the beneficiary may bring an action personally against the debtor for any deficiency. This statute of limitation is strictly enforced. Further, the statute will limit the lender's potential judgment to "no more than the amount by which the amount of the indebtedness with interest, costs, and expenses of sale, including trustee's and attorney's fees, exceeds the fair market value of

Copyright © 2012 Matthew M. Boley
All rights reserved

the property as of the date of the sale." Utah Code Ann. § 57-1-32. The prevailing party in such an action is entitled to collect its costs and reasonable attorneys' fees.

x. Federal Right of Redemption

The federal right of redemption applicable in the case of federal tax liens also applies to non-judicial foreclosures. Failure to give the United States proper notice will have serious negative ramifications. Among other things, the federal tax lien may survive the foreclosure even if it was a clearly junior lien. See 26 U.S.C. § 7425.

7. Purchaser in "Good Faith"

Under the Recording Act, an unrecorded interest in real property "is void as against any subsequent purchaser … if … the subsequent purchaser purchased the property in *good faith* and for a valuable consideration." Utah Code Ann. § 57-3-103 (emphasis added). "To be in good faith, [however,] a subsequent purchaser must take the property without notice of a prior unrecorded interest in the property." Salt Lake County v. Metro West Ready Mix, Inc., 89 P.3d 155, 158 (Utah 2004). Such "notice" is not limited to actual notice, but also includes constructive notice, including "inquiry notice which is presumed because of the fact that a person has knowledge of certain facts which should impart to him, or lead him to, knowledge of the ultimate fact." Id. Further, a fact need not impart "positive knowledge" of unrecorded property rights, but "need only [suggest] the *possibility* of the rights of another." Id. (citations omitted).

Accordingly, Utah law has long recognized that "[w]hatever is notice enough to excite attention and put the party on his guard and call for inquiry is notice of everything to which such inquiry might have led. When a person has sufficient information to lead him to a fact, he shall be deemed conversant of it." O'Reilly v. McLean, 37 P.2d 770, 775 (Utah 1934) (citations omitted). In Metro West, the Utah Supreme Court held that, because the purchaser had notice of the possibility that defects in its title might exist *before* purchasing property, such notice "precluded it [the purchaser] from taking the Property in good faith." Metro West, 89 P.3d at 158.

In short, a person who has actual and/or constructive knowledge of an unrecorded interest in property, whether legal or equitable, is not a "good faith" or "bona fide"

Copyright © 2012 Matthew M. Boley Last Updated Aug. 19, 2012
All rights reserved

purchaser. See Grahn v. Gregory, 800 P.2d 320, 328 (Utah App. 1990) ("A bona fide purchaser is 'one who takes without actual or constructive knowledge of facts sufficient to put him on notice of the complainant's equity.' ") (quoting Blodgett v. Martsch, 590 P.2d 298, 303 (Utah 1978)); Peterson v. Peterson, 112 Utah 554, 562, 190 P.2d 135, 139 (1948) ("*Good faith* … is dependent upon having *no notice, actual or constructive*,… and of having made such inquiry as the law would impose upon the purchaser under the facts of the particular case.") (emphasis added).

Such persons are not entitled to the protections of the Recording Act, and their interests in the Property, if any, are subject to any and all interests of which they had or have notice. See Utah Farm Prod. Credit Ass'n v. Wasatch Bank, 734 P.2d 904, 906 n.2 (Utah 1986) (per curium) ("actual or constructive notice defeats a subsequent purchaser's interest"); Diversified Equities, Inc. v. American Sav. & Loan Ass'n, 739 P.2d 1133, 1136 (Utah 1987) (holding that, if a subsequent purchaser has information or facts that would put a prudent person upon inquiry which, if pursued, would lead to actual knowledge, an unrecorded conveyance is not void as against that subsequent purchaser); Garland v. Fleishman, 831 P.2d 107, 112 (Utah 1992) (holding that the title of a person unable to avail herself of the protections afforded to bona fide purchasers under the recording statute is subject and inferior even to unrecorded interests in the property).

E. Mechanic's Liens

Mechanic's liens arise pursuant to statute, Utah Code Ann. § 38-1-1 et seq. The purpose of the mechanic's lien statute is to "provide protection to those who enhance the value of a property by supplying labor or materials," not to safeguard the rights of property owners. AAA Fencing Co. v. Raintree Dev. & Energy Co., 714 P.2d 289, 291 (Utah 1986).

Like most other liens treated under Utah law, the priority of a mechanic's lien is governed by the general rule of first-in-time, first-in-right. In short, the first lien to become perfected under Utah law has priority and superiority over later liens.

When a mechanic's lien is junior to the lien arising under a trust deed or mortgage, foreclosure (judicial or nonjudicial) discharges the mechanic's lien as against

Copyright © 2012 Matthew M. Boley Last Updated Aug. 19, 2012
All rights reserved

the property. When a mechanic's lien is senior to the lien arising under a trust deed or mortgage then, provided that the holder of the mechanic's lien has perfected the lien as required by Utah law, the mechanic's lien survives foreclosure and the successful purchaser at the trustee's sale will take title subject to the mechanic's lien.

1. Mechanic's Liens Relate Back to the First Work or Materials

By statute, all mechanic's liens share as their common priority date the date on which work first commenced on the property or on which materials first were delivered to the property. The statute provides:

> [Mechanic's liens] relate back to, and take effect as of, the time of the commencement to do work or furnish materials on the ground for the structure or improvement, and shall have priority over any lien, mortgage or other encumbrance which may have attached subsequently to the time when the building, improvement or structure was commenced, work begun, or first material furnished on the ground; also over any lien, mortgage or other encumbrance of which the lien holder had no notice and which was unrecorded at the time the building, structure or improvement was commenced, work begun, or first material furnished on the ground.

Utah Code Ann. § 38-1-5. Further, all mechanic's lien claimants share this same, earliest priority date irrespective of when their work is performed or their materials are provided.

Accordingly, if a trust deed is not recorded prior to commencement of work or the first delivery of materials, then the trust deed will be junior to all properly perfected mechanic's liens.

2. Perfecting and Enforcing Mechanic's Liens.

Because mechanic's liens are creatures of statute, claimants seeking to enforce a lien must strictly comply with all prerequisites imposed by the statute. If a lien claimant fails to take timely action to perfect its lien, then the lien shall be void and unenforceable.

The recording deadline is the first condition that a mechanic's lien claimant must satisfy to perfect its lien. By statute, written notice of the mechanic's lien must be recorded within (A) "180 days after the day on which occurs final completion of the original contract if no notice of completion is filed," or (B) "90 days after the day on

Copyright © 2012 Matthew M. Boley Last Updated Aug. 19, 2012
All rights reserved

which a notice of completion is filed." Utah Code Ann. § 38-1-7(1)(a)(i). Failure to meet this deadline invalidates the lien.

What does and does not constitute "final completion" has been the subject of some debate and litigation. In 2004, the Utah Supreme Court explained: "absent a breach, 'final completion of the original contract' means that all obligations contemplated by the initial agreement must be satisfied before the statute of repose begins to run." R.A. McKell Excavating, Inc. v. Wells Fargo Bank, N.A., 2004 UT 48, ¶ 14. The R.A. McKell court elaborated:

> The American Heritage Dictionary defines "final" as "[p]ertaining to or constituting the end result of a process or procedure." The American Heritage Dictionary of the English Language 492 (1981). In turn, "completion" is defined as "[t]he act of concluding, perfecting, or making entire." Id. at 272. Thus, given the plain and ordinary meaning of these words, it is clear that "final completion of the original contract" necessarily implies the satisfaction of all obligations contemplated by the initial agreement..

Id. ¶ 10.

The mechanic's lien claimant also must mail a copy of the notice of lien to both the reputed owner and the record owner of the property within thirty days after recording the notice of lien. Failure to do so will not invalidate the lien, but it will preclude the mechanic's lien claimant from recovering attorneys' fees and costs as against such an owner.

The statute next mandates that: "[a] lien claimant shall file an action to enforce the lien filed under this chapter within 180 days from the day on which the lien claimant filed a notice of claim." Utah Code Ann. § 38-1-11(2). The statute further provides: "A lien filed under this chapter is automatically and immediately void if an action to enforce the lien is not filed within the time required …." Utah Code Ann. § 38-1-11(4)(a); see also, e.g., AAA Fencing Co. v. Raintree Dev. & Energy Co., 714 P.2d 289, 292 (Utah 1986) ("The time for enforcing mechanics' liens set out in *section 38-1-11*, *supra*, limits a lienor's rights …. At that point, both his rights and his remedies under the statute are extinguished."). Accordingly, the deadline to file suit is jurisdictional. If suit is not filed

Copyright © 2012 Matthew M. Boley
All rights reserved

on or before the 180 day deadline, the lien shall not be valid and the courts shall lack jurisdiction to grant any relief to the lien claimant.

Finally, the mechanic's lien claimant also must record a lis pendens to give notice of the pendency of the lawsuit within 180 days after the notice of claim was recorded. If the claimant fails timely to record a lis pendens, "the lien shall be void, except as to persons who have been made parties to the action and persons having actual knowledge of the commencement of the action." Utah Code Ann. § 38-1-11(3)(a).

3. Effect of Foreclosure on Mechanic's Liens.

If the first work was performed or first materials were delivered prior to the recording of a trust deed or mortgage, then mechanic's liens will have priority over the later filed consensual lien. Under such circumstances, foreclosure (judicial or non-judicial) of the junior trust deed or mortgage will not disturb the mechanic's liens. The mechanic's liens will survive the foreclosure, the purchaser at the trustee's sale will take title subject to the mechanic's liens and the mechanic's lien claimant will have no claim to any portion of the proceeds of the trustee's sale.

If, on the other hand, a trust deed or mortgage is recorded before commencement of work, then the trust deed will have priority over all mechanic's liens. Under such circumstances, the junior mechanic's liens will be discharged as against the property by the foreclosure of the senior trust deed or mortgage.

In this regard, the trust deed statute provides: "The trustee's deed shall operate to convey to the purchaser, without right of redemption, the trustee's title and all right, title, interest, and claim of the trustor and the trustor's successors in interest and of all persons claiming by, through, or under them, in and to the property sold, including all right, title, interest, and claim in and to the property acquired by the trustor or the trustor's successors in interest subsequent to the execution of the trust deed, which trustee's deed shall be considered effective and relate back to the time of the sale." Utah Code Ann. § 57-1-28(3). In the related context of judicial foreclosure, Utah's courts have declared: "A junior mortgagee who is joined and properly served in an action by a senior mortgagee to foreclose his mortgage, whether or not he appears or pleads, is bound by the

Copyright © 2012 Matthew M. Boley Last Updated Aug. 19, 2012
All rights reserved

decree of foreclosure and may not thereafter assert a claim against said mortgaged property." Cowan v. Stoker, 100 Utah 377, 380; 115 P.2d 153, 154 (1941).

When the trustee's sale occurs, "the surplus from the sale[, if any,] stands in the place of the foreclosed real estate and is subject to the same liens and interests that were attached to it." Randall v. Valley Title, 681 P.2d 219, 221 (Utah 1984). "[T]he res securing [junior liens] [i]s converted from realty to personal property--specifically, the excess proceeds." Property at 2793 South 3095 West v. Munford, 2000 UT App 116, ¶ 12, 1 P.3d 1116, 1119 (2000).

In short, foreclosure of a trust deed or mortgage extinguishes junior liens, including junior mechanic's liens. Such liens survive, if at all, only as against the excess proceeds from the trustee's sale or judicial foreclosure sale.

4. The Lien Restriction Act.

An owner of a residence, as defined by the Lien Restriction Act, is protected from mechanic's liens filed by a person or entity with whom the owner did not directly contract. See Utah Code Ann. § 38-11-107(1) (2001). A "[r]esidence" is "an improvement to real property used or occupied, to be used or occupied as, or in conjunction with, a primary or secondary detached single-family dwelling or multifamily dwelling up to two units." Id. § 38-11-102(20).

The Lien Restriction Act protects homeowners from having to pay twice for the same improvements. See id. §§ 38-11-107, 38-11-204(3)(b). It does so by providing that once the homeowner has paid the general contractor in full, the homeowner and the home are then free from claims and liens of subcontractors who also worked on the home. See, e.g., id. § 38-11-107(1) (providing owners relief only against parties with agreements "other than directly with the owner"); id. § 38-11-204(3)(b) (providing owners relief only after the owner "has paid in full the original contractor"); id. § 38-11-102(14) (defining "original contractor" as "a person who contracts with the owner of real property").

In such cases, Lien Restriction Act instructions and the forms referenced in section 38-1-11(4)(a) allow the owner of a residence to dispose of the case quickly and easily, without having to incur the expenses of litigation.

Copyright © 2012 Matthew M. Boley
All rights reserved

IV. Credit and Bankruptcy Issues

A. The Automatic Stay

1. Understanding the "Automatic Stay"

Section 362(a) of title 11 of the United States Code (the "**Bankruptcy Code**") imposes what in common parlance is described as the "automatic stay." Under this statute, the filing of a petition for bankruptcy relief (whether voluntary or involuntary) "operates as a stay, applicable to all entities, of," among other things: (i) filing or continuing to prosecute a lawsuit, administrative proceeding or arbitration; (ii) enforcing a judgment against the debtor or against property of the estate; (iii) "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;" (iv) any act to take, create, perfect or enforce a lien against property of the estate (whether by attachment, execution, foreclosure or otherwise); (v) any act to take, create, perfect or enforce a lien against property of the debtor; (vi) any act to collect or recover a claim from the debtor; and (vii) "the setoff of any debt owing to the debtor … against any claim against the debtor …." 11 U.S.C. § 362(a).

The "automatic stay" serves several purposes. "First, it gives a bankrupt a breathing spell from creditors by stopping all collection efforts, all harassment, and all foreclosure actions. The stay permits a bankrupt to attempt a repayment or reorganization plan or simply to be relieved of the financial pressures that drove him into bankruptcy. Second, the stay protects creditors by preventing particular creditors from acting unilaterally in self-interest to obtain payment from a debtor to the detriment of other creditors. In other words, the stay 'protect[s] the bankruptcy estate from being eaten away by creditors' lawsuits and seizures of property before the trustee has had a chance to marshal the estate's assets and distribute them equitably among the creditors.' " Maritime Elec. Co., Inc. v. United Jersey Bank, 959 F.2d 1194, 1204 (3d Cir. 1991) (citations omitted).

Once a bankruptcy is filed, a creditor must be very careful not to violate the automatic stay. Under section 362(k) of the Bankruptcy Code a creditor who willfully violates the automatic stay will be liable for any "actual damages, including costs and

Copyright © 2012 Matthew M. Boley
All rights reserved

attorneys' fees" occasioned by his action or inaction. 11 U.S.C. § 362(k). "A willful violation does not require a specific intent to violate the stay, rather, it provides for damages upon a finding that the defendant knew of the automatic stay and that his actions in violation of the stay were intentional." Progressive Motors, Inc. v. Frazier, 220 B.R. 476, 478 (D. Utah 1998) (Kimball, J.). Nevertheless, even where a creditor's violation of the automatic stay is merely negligent, the creditor may be subject to damages for civil contempt if the debtor or its estate are injured. See, e.g., Utah State Credit Union v. Skinner (In re Skinner), 90 B.R. 470, 475-481 (D. Utah 1988) (Winder, J.) (discussing the imposition of civil contempt upon creditor whose violation of the automatic stay was not willful).

Further, under the authority of section 362(k) and the bankruptcy court's inherent contempt powers, the debtor also may seek and obtain sanctions or punitive damages against a creditor whose willful violation of the automatic stay is "egregious" and "intentional." See, e.g., Progressive Motors, 220 B.R. at 479 (affirming award of punitive damages in the amount of $30,000 for creditor's willful violation of the automatic stay); see also In re Jackson, 251 B.R. 597, 601 (Bankr. D. Utah 2000) (Clark, J.) (explaining standard for imposing punitive damages under section 362(h))

Accordingly, a creditor should take no action which does or may violate the automatic stay. Further, if a creditor unknowingly violates the automatic stay, it should immediately act to restore the status quo once becoming aware of the bankruptcy. With respect to real property foreclosures, *i.e.*, trustee's sales, the creditor should not record a notice of default or notice of sale. If the sale already has been noticed, the sale should not be held although, arguably, it may be permissible for the trustee or his representative to appear and continue the date of the trustee's sale to a later date. Further, if a notice of default or notice of sale is recorded in ignorance of the automatic stay, the creditor should take action to withdraw the notice.

With respect to UCC foreclosures, the creditor should not proceed with repossession or sale of the collateral. Furthermore, if the creditor has obtained repossession but has not completed disposition of the collateral, the creditor may violate

Copyright © 2012 Matthew M. Boley Last Updated Aug. 19, 2012
All rights reserved

the automatic stay by refusing to turn-over the collateral to the debtor. See, e.g., In re Jackson, 251 B.R. 597, 601 (Bankr. D. Utah 2000) ("withholding possession of estate property that was seized prepetition is an exercise of control over property of the estate that is expressly prohibited by § 362(a)(3) and is a violation the automatic stay").

Finally, with respect to nonbankruptcy litigation, the creditor should not proceed to seek or obtain judgment or any pre- or post-judgment remedies. If judgment is entered or other judicial process (including garnishment and execution) occurs after the bankruptcy, the creditor should take affirmative steps to restore the pre-bankruptcy status quo. This may require the creditor to file a motion to set aside the judgment and/or to release or reverse a garnishment, execution or other judicial process.

In short, the Bankruptcy Code's automatic stay is nothing to be trifled with. Violations of the automatic stay, even unknowing violations, may expose a creditor to liability for actual and punitive damages. Accordingly, where the automatic stay is concerned, it is always better to err on the side of caution. In this regard, even in instances where the creditor believes that the automatic stay does not apply, it may be prudent to seek relief from the automatic stay out of an abundance of caution.

2. Exceptions to the Automatic Stay

Subsection (b) of section 362 of the Bankruptcy Code lists various exceptions to the automatic stay. Exceptions of note include: (i) the commencement or continuation of criminal proceedings (including an award of criminal restitution); (ii) the commencement or continuation of a proceeding to establish and/or collect paternity, alimony, maintenance and/or support; (iii) certain governmental proceedings; (iv) tax audits; and (v) certain acts to perfect or continue the perfection of a security interest. See 11 U.S.C. § 362(b).

In 2005, Congress amended the Bankruptcy Code in several ways. One of these was to expand the exceptions to the automatic stay. Some of the notable newer exceptions are as follows:

(a) the automatic stay does not apply if the current case was filed within 180 days of a prior bankruptcy that was dismissed (1) by the court for "willful

Copyright © 2012 Matthew M. Boley
All rights reserved

failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case," or (2) upon request of the debtor following the filing of a request for relief from the automatic stay. See 11 U.S.C. §§ 362(b)(21) and 109(g).

(b) if the court enters an order granting "relief" from the automatic stay as to real property in any earlier case pursuant to section 362(d)(4) – i.e., if "the filing of the petition was part of a scheme to delay, hinder, or defraud creditors – then the automatic stay in any subsequent bankruptcy will not apply to such property for a period of two years. See 11 U.S.C. §§ 362(b)(20).

(d) the automatic stay does not prevent the continuation of an eviction proceeding if (i) the landlord obtained a judgment or restitution or judgment for possession pre-petition, or (ii) if the eviction proceeding is based on endangergment of the property or illegal use of a controlled substances on the property. See 11 U.S.C. §§ 362(b)(22) and (23).

The 2005 bankruptcy amendments also limited the applicability of the stay in the case of serial bankruptcy filing. Specifically, "Congress enacted § 362(c)(4) with Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 as a means to discourage bad faith repeat filings." In re Underhill, 425 B.R. 614, 617 (Bankr. D. Utah 2010).

If one prior case was pending and dismissed (excepting only cases dismissed under section 707(b)) within the preceding one year, then the automatic stay "shall terminate *with respect to the debtor* on the 30th day after the filing of the later case." 11 U.S.C. §§ 362(c)(3)(A) (emphasis added). Please note, however, that the termination of the stay only applies to the debtor and its property. Indeed, "the plain language of § 362(c)(3)(A) dictates that the 30–day time limit applies only to 'debts' or 'property of the debtor' and not to 'property of the estate.' Based upon this reasoning, the automatic stay continues to protect 'property of the estate' after expiration of the 30–day time limit found in § 362(c)(3)(A)." In re Hollingsworth, 359 B.R. 813, 813-14 (Bankr. D. Utah 2006) (Clark, J.); see also In re Galanis, 334 B.R. 685, 690 n.6 (Bankr. D. Utah 2005)

Copyright © 2012 Matthew M. Boley Last Updated Aug. 19, 2012
All rights reserved

(Thurman, J.) (“The meaning of § 362(c)(3) is ambiguous in that it states the automatic stay shall be lifted “as to the debtor.” It is not necessarily clear to the Court what this means. The Court is mindful of this ambiguity, but need not interpret this part of § 362 in the present opinion.”).

If, however, a debtor has filed two or more bankruptcy case within a one year period that were dismissed (other than under section 707(b)), then the automatic “stay does not go into effect. A creditor is not stayed from numerous actions including enforcing a lien that arose before the commencement of the case against property of the estate.” Underhill, 425 B.R at 617; 11 U.S.C. §§ 362(c)(4)(A)(i) (“the stay … shall not go into effect.”).

In either of these instances, however, the debtor or any other party-in-interest may file a motion asking the court to extend or impose the stay. To obtain such relief, the debtor or party-in-interest must prove by clear and convincing evidence that “the filing of the later case is in good faith.” Further, the debtor’s motion to extend or impose the stay must be filed within thirty days after the petition date.

Finally, the 2005 bankruptcy amendments created an exception to the automatic stay applicable to a small business debtor (i) who was a debtor in another small business case pending at the time the petition is filed, (ii) whose prior small business case was dismissed for any reason within 2 years prior to the order for relief in the new case, (iii) who was a debtor in a prior small business case where the plan was confirmed within 2 years prior to the order for relief entered in the new case, or (iv) the debtor is an entity that acquired substantially all of the assets of a small business debtor satisfying any of the foregoing criteria, unless the successor entity proves that it acquired the assets in good faith and not for the purpose of avoiding this exception to the automatic stay. See 11 U.S.C. § 362(n)(1). There are certain limited circumstances under which the debtor may avoid this exception, including (a) involuntary cases not involving collusion, and (b) where the new filing “resulted from circumstances beyond the control of the debtor not foreseeable at the time the [prior] case … was filed.” 11 U.S.C. § 362(n)(2)

Copyright © 2012 Matthew M. Boley
All rights reserved

3. Relief from the Automatic Stay

Section 362(d) of the Bankruptcy Code provides that a creditor may obtain relief from the automatic stay under certain circumstances. The forms of relief available include termination, annulment, modification and the imposition of conditions on continuation of the stay. The statute provides, in pertinent part:

> On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under [section 362(a)], such as by terminating, annulling, modifying, or conditioning such stay—
>
> (1) for cause, including the lack of adequate protection of an interest in property of such party in interest;
>
> (2) with respect to a stay of an act against property under subsection (a) of this section, if—
>
> (A) the debtor does not have an equity in such property; and
>
> (B) such property is not necessary to an effective reorganization;
>
> (3) [in a single asset real estate case, if the debtor does not file a plan or commenced monthly payments to the creditor within 90 days after commencement of the case or such longer period as may be ordered by the Bankruptcy Court]; or
>
> (4) with respect to a stay of an act against real property … by a creditor whose claim is secured by … such real property, if the court finds that the filing was part of a scheme to delay, hinder, and defraud creditors that involved either—
>
> (A) transfer of all or part ownership of, or other interest in, such real property without the consent of the secured creditor or court approval; or
>
> (B) multiple bankruptcy filings affecting such real property.

The procedure for seeking relief from the automatic stay is governed by Federal Rule of Bankruptcy Procedure 4001 and Bankr. D. Ut. LBR 4001-1. Further, pursuant to section 362(g), the party seeking relief from the automatic stay will have the burden of

Copyright © 2012 Matthew M. Boley
All rights reserved

proof only on the issue of the debtor's equity in property, while the party opposing the motion for relief will have the burden of proof on all other issues.

"Cause" under section 362(d)(1) is very broad and is susceptible of different meanings in cases under different chapters of the Bankruptcy Code. For example, in chapter 13 cases, default in post-petition payments under a proposed and/or confirmed chapter 13 plan may constitute "cause" for terminating the stay. See, e.g., In re Binder, 224 B.R. 483, 491 (Bankr. D. Colo. 1998) ("Where a creditor is permissibly 'paid outside a Chapter 13 plan,' the policies of Chapter 13 and the provisions of the confirmed plan may be best served by granting the creditor relief from automatic stay for post-confirmation defaults."); In re Williams, 68 B.R. 442 (Bankr. M.D. Ga. 1987) ("[L]ack of adequate protection is only one example of 'cause' for relief from the stay…. The issues of adequate protection and equity in the property are irrelevant in the face of post-confirmation payment defaults because creditors are entitled to rely upon the debtors' responsibilities to make their post-confirmation payments."); Ellis v. Parr (In re Ellis), 60 B.R. 432, 435 (B.A.P. 9th Cir. 1985) ("Failure to make post-confirmation payments can constitute cause for lifting the stay."); In re Davis, 64 B.R. 358, 359-60 (Bankr. S.D.N.Y. 1986) (same). As another example, cause also will exist (under any chapter of the Bankruptcy Code) where the creditor shows that the debtor does not own the property at issue, notwithstanding the fact that the property is listed in the debtor's schedules of assets and liabilities. In fact, if the property is neither property of the debtor nor its bankruptcy estate, then the stay probably would not apply. Nevertheless, where the debtor claims ownership of such property, it is prudent to seek relief from the automatic stay out of an abundance of caution, to avoid the draconian sanctions imposed upon creditors who knowingly violate the automatic stay.

Generally, however, the "cause" proffered in support of a motion for relief from the automatic stay is lack of adequate protection. The mere failure of the debtor to make post-petition payments does not establish lack of adequate protection. Rather, the moving creditor must be prepared to show; (i) that there is little or no equity in its collateral and the value of the collateral is depreciating; (ii) that the collateral is

Copyright © 2012 Matthew M. Boley Last Updated Aug. 19, 2012
All rights reserved

uninsured; (iii) that the collateral is at risk of loss, destruction or casualty; (iv) that the collateral is being depleted or wasted; and/or (v) that the value or continued existence of the collateral is otherwise at risk.

Section 362(d)(2) provides a creditor the right to relief from the automatic stay if he can establish two things: first, that the debtor has no equity in the property; and second, that the property is not necessary for an effective reorganization. Because reorganization is not at issue in chapter 7 cases, this alternative basis for relief is much easier to establish in chapter 7 cases. In cases under chapters 11 and 13, it may be nigh impossible for a creditor to obtain relief under section 362(d)(2), as the debtor need only produce credible evidence suggesting that the property may be necessary for a successful reorganization.

Since 2005, the bankruptcy stay will terminate automatically as to certain creditors whose claims are secured by personal property in chapter 7 case filed by individuals. In such cases, the debtor must either enter into a reaffirmation agreement with the creditor, pursuant to section 524(c), or redeem the collateral pursuant to section 722 not later than 45 days after the first meeting of creditors. See 11 U.S.C. § 521(a)(6). If the debtor does not, then the automatic stay automatically (without notice, hearing or order) is terminated with respect to the applicable personal property. See 11 U.S.C. §§ 521(a)(6) and 362(h) This termination can be avoided, however, (i) if the trustee files a motion prior to expiration of the 45-day period seeking to extend the stay, (ii) the court determines, after notice and hearing, "that such property is of consequential value or benefit to the estate," (iii) the court orders appropriate adequate protection to the creditor, and (iv) the court orders the debtor to deliver the collateral to the trustee. See id.

B. Use, Sale or Lease of Real Property

Where a sound business reason exists and the sale would be in the interests of creditors, the Bankruptcy Court may approve a use, sale or lease of some or substantially all of the debtor's assets prior to confirmation of a plan. See 11 U.S.C. § 363(b)(1).

The sale described in Judge Thurman's reported decision In re Medical Software Solutions, Inc., 268 B.R. 431 (2002) is a good example of a successful sale under section

Copyright © 2012 Matthew M. Boley
All rights reserved

363 of the Bankruptcy Code. Less than 30 days after the case was filed, the debtor filed a motion to sell substantially all of its assets to an "insider." The debtor had engaged in substantial efforts to locate a buyer of the debtor as a "going concern" both pre- and post-petition.

Upon a "first day" motion by the debtor, which was joined by the US Trustee, the court had appointed an "examiner" to investigate the possibility of a sale of substantially all of the debtor's assets to an insider. After a full evidentiary hearing and after considering the examiner's report, the Court concluded that a "sound business purpose" existed for the sale, that the price was fair and reasonable, that notice was reasonable, and that the buyer was acting in good faith. Applying these facts to the law, more fully described below, the sale was approved two months and one day after the bankruptcy case first was filed.

A sale of a debtor's assets should be authorized pursuant to Bankruptcy Code section 363 if a sound business purpose exists for doing so. See, e.g., In re Lionel Corp., 722 F.2d 1063 (2d Cir. 1983); In re Martin, 91 F.3d 395 (3d Cir. 1996); In re Titusville Country Club, 128 B.R. 396 (W.D. Pa. 1991); In re Industrial Valley Refrigeration and Air Conditioning Supplies, Inc., 77 B.R. 15 (E.D. Pa. 1987); In re Ancor Exploration Co., 30 B.R. 802, 808 (N.D.Okl. 1983) (bankruptcy court has wide-latitude in approving sale of substantially all of the estate assets under section 363(b)); In re Allison, 39 B.R. 300, 301-02 (D.N.M. 1984) ("The clear weight of authority authorizes the sale of all or substantially all of the debtor's assets pursuant to Section 363(b) in a chapter 11 proceeding, even absent a disclosure statement, plan, and vote of the creditors.").

"In order to approve a sale of substantially all the Debtor's assets outside the ordinary course of business, the following elements must be met. The Debtor must show (1) that a sound business reason exists for the sale; (2) there has been adequate and reasonable notice to interested parties, including full disclosure of the sale terms and the Debtor's relationship with the buyer; (3) that the sale price is fair and reasonable; and (4) that the proposed buyer is proceeding in good faith." Medical Software Solutions, Inc., 268 B.R. at 439-40. See also Lionel Corp., 722 F.2d at 1071 (identifying the "sound

Copyright © 2012 Matthew M. Boley
All rights reserved

business purpose" test); In re Abbotts Dairies of Penn., Inc., 788 F.2d 143, 145-47 (3d Cir. 1986) (implicitly adopting the articulated business justification test of Lionel, and adding the "good faith" requirement); In re Delaware & Hudson Ry. Co., 124 B.R. 169, 176 (D. Del. 1991) (adopting Lionel).

As Collier notes:

> There has been disagreement historically on the issue of whether and under what circumstances a chapter 11 debtor may sell substantial assets under section 363. It is now generally accepted that section 363 allows such sales in chapter 11, provided, however, that the sale proponent demonstrates a good, sound business justification for conducting the sale prior to confirmation (other than appeasement of the loudest creditor), that there has been adequate and reasonable notice of the sale, that the sale has been proposed in good faith, and that the purchase price is fair and reasonable. These factors are considered to assure that the interests of all parties in interest are protected and that the sale is not for an illegitimate purpose.

3 Collier on Bankruptcy (15th Rev. 2002), ¶363.02[4].

Under Bankruptcy Code section 363(f), a debtor-in-possession may sell property free and clear of any lien, claim or interest in such property if:

> (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
>
> (2) such entity consents;
>
> (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
>
> (4) such interest is in bona fide dispute; or
>
> (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

11 U.S.C. § 363(f).

Because Bankruptcy Code section 363(f) is drafted in the disjunctive, satisfaction of any one of its five requirements will suffice to approve the sale of the Assets free and clear of liens, claims, encumbrances, and other interests (collectively, the "**Interests**"). See 11

Copyright © 2012 Matthew M. Boley
All rights reserved

U.S.C. § 363(f); Michigan Employment Security Comm'n v. Wolverine Radio Co. (In re Wolverine Radio Co.), 930 F.2d 1132, 1147 n.24 (6th Cir. 1991) (section 363(f) written in disjunctive; court may approve sale "free and clear" provided at least one of the subsections is met); Citicorp Homeowners Servs., Inc. v. Elliot (In re Elliot), 94 B.R. 343 (E.D. Pa. 1988) (same).

Likewise, a plan of reorganization or plan of liquidation in a chapter 11 case may provide for the sale of some or all of the debtor's assets. See 11 U.S.C. §§ 1123(a)(5)(D) and 1123(b)(4). As with sales under section 363 of the Bankruptcy Code, sales pursuant to a confirmed plan may be "free and clear." 11 U.S.C. § 1129(b)(2)(A)(ii).

Under a confirmed plan, the debtor also may have the option of substituting collateral or other consideration which provides the "indubitable equivalent" to the secured creditor. 11 U.S.C. § 1129(b)(2)(A)(iii). In this manner, the Debtor may be able to sell assets subject to lien and use the money without paying the proceeds to the secured creditor.

C. Rejection vs. Assumption (and Assignment) of Leases

The Bankruptcy Court empowers a debtor in bankruptcy (a) to cure defaults under pre-bankruptcy contracts and leases, and (b) to assign those contracts to third parties. The Code also empowers debtors to "reject" unexpired leases and executory contracts.

Under Bankruptcy Code section 365(a), a debtor, "subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor." 11 U.S.C. § 365(a). Bankruptcy Code section 365(b)(1), in turn, codifies the requirements for assuming an unexpired lease or executory contract of a debtor. This subsection provides:

> (b)(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee—
>
> (A) cures, or provides adequate assurance that the trustee will promptly cure, such default;
>
> (B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual

Copyright © 2012 Matthew M. Boley
All rights reserved

> pecuniary loss to such party resulting from such default; and
>
> (C) provides adequate assurance of future performance under such contract or lease.

11 U.S.C. § 365(b)(1).

The meaning of "adequate assurance of future performance" depends on the facts and circumstances of each case, but should be given "practical, pragmatic construction." EBG Midtown South Corp. v. McLaren/Hart Env. Engineering Corp. (In re Sanshoe Worldwide Corp.), 139 B.R. 585, 593 (S.D.N.Y. 1992); see In re Prime Motor Inns Inc., 166 B.R. 993, 997 (Bankr. S.D. Fla. 1994) ("[a]lthough no single solution will satisfy every case, the required assurance will fall considerably short of an absolute guarantee of performance"); Carlisle Homes, Inc. v. Azzari (In re Carlisle Homes, Inc.), 103 B.R. 524, 538 (Bankr. D.N.J. 1988).

Among other things, adequate assurance may be provided by demonstrating the assignee's financial health and experience in managing the type of enterprise or property assigned. See, e.g., In re Bygaph, Inc., 56 B.R. 596, 605-06 (Bankr. S.D.N.Y. 1986) (adequate assurance of future performance is present when prospective assignee of lease from debtor has financial resources and has expressed willingness to devote sufficient funding to business in order to give it strong likelihood of succeeding).

Assignment of contracts and leases is permitted under section 365(f)(2) of the Bankruptcy Code, which provides, in pertinent part:

> The trustee may assign an executory contract or unexpired lease of the debtor only if—
>
> (A) the trustee assumes such contract or lease in accordance with the provisions of this section; and
>
> (B) adequate assurance of future performance by the assignee of such contract or lease is provided, whether or not there has been a default in such contract or lease.

11 U.S.C. § 365(f)(2).

In short, the rights of landlords and tenants regarding the termination, cure and/or assignment of a lease are governed by section 365 of the Bankruptcy Code. Generally, a bankrupt tenant has the option either (i) to reject and abandon the lease, or (ii) to cure any

Copyright © 2012 Matthew M. Boley Last Updated Aug. 19, 2012
All rights reserved

existing defaults and assume the lease. The tenant also may be permitted to assign the lease to a third party, provided that any defaults are cured and provided further that the third party is able to provide adequate assurance of future performance.

Unless and until the lease has been rejected, a tenant's obligation to pay post-petition rent ordinarily will be treated as an administrative expense, which will receive priority in the order of payment in the bankruptcy case. See 11 U.S.C. §§ 503(b)(1)(A) and 507(a)(2).

Finally, the claim of a landlord of a bankrupt tenant is statutorily circumscribed. The landlord's claim for damages resulting from termination of the lease (including a rejection of the lease pursuant to section 365) is limited to (i) unpaid rent due on the earlier of the date of the filing of the petition or the date on which the lessor repossessed or the lessee surrendered the premises, plus (ii) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of the lease after such date. See 11 U.S.C. § 502(b)(6).

D. Other Bankruptcy Considerations

1. Filing a Proof of Claim

Generally, if a creditor desires or intends to participate in distributions from a bankruptcy estate, it must file a proof of claim on or before the proof of claim deadline. See Fed. R. Bankr. Pro. 3002(a) ("An unsecured creditor or an equity security holder must file a proof of claim or interest for the claim or interest to be allowed, except as provided in Rules 1019(3), 3003, 3004 and 3005."); 11 U.S.C. § 502(b)(9) (providing that, except in limited circumstances, a claim should be disallowed to the extent proof of the claim "is not timely filed"). In chapter 7 and chapter 13 cases, the proof of claim deadline generally will be "90 days after the first date set for the meeting of creditor under section 341(a) of the [Bankruptcy] Code." This deadline normally will be identified on the Notice of Bankruptcy form that is mailed to all known and identified creditors upon commencement of a bankruptcy case.

In a chapter 7 no asset case, usually no proof of claim deadline will be established, and creditors are discouraged (but not prohibited) from filing proofs of claim.

Copyright © 2012 Matthew M. Boley Last Updated Aug. 19, 2012
All rights reserved

If the trustee subsequently determines that assets will be available for distribution, a proof of claim deadline will be established as the date which is ninety (90) days after the clerk mails notice of the potential dividend.

A creditor may not need to file a proof of claim in a chapter 11 case, if it agrees with the amount of its claim as listed in the debtor's schedules of assets and liabilities, and if the claim is not scheduled as disputed, contingent or unliquidated. See 11 U.S.C. § 1111(a); Fed. R. Bankr. Pro. 3003(b)(1).

As defined in the Federal Rules of Bankruptcy Procedure, "[a] proof of claim is a written statement setting forth a creditors claim." Fed. R. Bankr. Pro. 3001(a). Furthermore, the Bankruptcy Rules mandate that "[a] proof of claim shall conform substantially to the appropriate Official Form." Id. Accordingly, for the convenience of the creditor and to comply with applicable bankruptcy law, creditors should use the official bankruptcy form—Form B10 (Official Form 10)—to file proof of their claim.

To constitute a valid proof of claim, the claim: (i) must be in writing; (ii) must contain a "demand by the creditor on the debtor's estate;" (iii) "the writing [must express] an intent to hold the debtor liable for the debt;" and (iv) must be filed with the bankruptcy court. Rushton v. Philadelphia Forest Prods., Inc. (In re Americana Expressways, Inc.), 161 B.R. 707, 713 n.11 (D. Utah 1993) (citing Clark v. Valley Fed. Savs. & Loan Ass'n (In re Reliance Equities, Inc.), 966 F.2d 1338, 1344 (10th Cir. 1992)). The proof of claim must be signed either by the creditor or its authorized representative. If the creditor's claim is based upon a writing, it must attach a copy of the writing (unless the writing(s) is(are) voluminous, in which case the creditor much attach a summary). Further, if a creditor files a secured claim, it must attach evidence of perfection of its security interest.

Filing a proof of claim will have consequences that should be considered by the creditor before it files a proof of claim. First, as stated at the bottom of the proof of claim form, a person who presents a fraudulent claim will subject himself to criminal prosecution. Furthermore, filing a proof of claim subjects the claimant to the jurisdiction of the Bankruptcy Court and will cause a waiver of the right to a jury trial. In most cases this should not be a deterrent. The creditor should seriously consider whether to file a

Copyright © 2012 Matthew M. Boley
All rights reserved

proof of claim, however, where the creditor may be the target of a preference action under section 547 of the Bankruptcy Code, a fraudulent transfer lawsuit under sections 548 and/or 544 of the Bankruptcy Code or any other affirmative claims by the debtor or the bankruptcy trustee. A counterclaim (but not a defense) in litigation brought by the trustee or the debtor will constitute a proof of claim for purpose of waiving the right to a jury trial.

2. The Meeting of Creditors

Within a reasonable time after the bankruptcy case is filed, the United States trustee will convene a meeting of creditors. See 11 U.S.C. § 341(a). Notice of the meeting will be provided to all creditors listed on the debtor's mailing matrix at least twenty days in advance of the meeting. See Fed. R. Bankr. Pro. 2002(a)(1). A representative of the United States Trustee or, if a trustee has been appointed in the case, the appointed trustee will preside at the meeting.

Pursuant to section 343 of the Bankruptcy Code, the debtor is required to "appear and submit to examination under oath at the meeting of creditors under section 341(a) …." 11 U.S.C. § 343. By statute, creditors have the right to examiner the debtor at this meeting. See id. This is the creditor's opportunity to elicit testimony from the debtor or its representative on any relevant subject matter, including the debtor's assets and liabilities and any pre-petition transfers of the debtor's property. It also is often used by secured creditors as an opportunity to obtain a statement of the debtor's intentions regarding the creditor's collateral and/or to discuss reaffirmation.

3. Post-Petition Credit

Section 364 of the Bankruptcy Code governs the debtor's ability to obtain secured and unsecured credit post-petition. Generally, the debtor is authorized to obtain unsecured credit and to incur unsecured debt in the ordinary course of its business. See 11 U.S.C. § 364(a). If, however, the post-petition creditor desires to obtain administrative priority or collateral for the post-petition debt, the financing terms must be approved by order of the bankruptcy court, after notice and a hearing. See 11 U.S.C. § 364(b), (c) and (d).

Copyright © 2012 Matthew M. Boley Last Updated Aug. 19, 2012
All rights reserved

4. Use of Cash Collateral

As defined in the Bankruptcy Code, " 'cash collateral' mean cash, negotiable instruments, documents of tile, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits of property and the fees, charges, accounts or other payments for the use or occupancy of room and other public facilities in hotels, motels, or other lodging properties subject to a security interest as provided in section 552(b) of [title 11], whether existing before or after the commencement of a [bankruptcy] case …." 11 U.S.C. § 363(a).

After a bankruptcy case has been filed, the debtor may not "use, sell, or lease cash collateral" unless (i) the person having a lien or other interest in the cash collateral "consents" or (ii) the court authorizes the debtor's use of the cash collateral, after notice and a hearing. Generally, in order to obtain court authorization, the debtor must prove that the creditor's lien or interest in the cash collateral is adequately protected.

5. Adequate Protection

Although the "automatic stay" prohibits a secured creditor from taking any action to seize, collect or liquidate its collateral, the Bankruptcy Code requires that the secured creditor's substantive property rights must be protected. Indeed, "lack of adequate protection" is specifically identified as a ground for relief from the automatic stay. 11 U.S.C. § 362(d)(1).

Accordingly, the chapter 7 trustee (and/or the debtor) is required to maintain casualty insurance on the creditor's collateral. Further, the trustee and debtor are required to perform ordinary maintenance on the collateral, and should not be allowed to take actions that will injure, destroy or otherwise diminish the value of the collateral. Further, if the value of the collateral is depreciating, and there is little or no equity cushion to protect the secured creditor's claim, then the trustee and/or debtor may be required "to make a cash payment or periodic cash payments" to the creditor, or may be required to provide the creditor with additional or replacement liens. 11 U.S.C. § 361.

Copyright © 2012 Matthew M. Boley
All rights reserved

6. Scope and Amount of Secured Claim – Claim Bifurcation

A claim is treated as "a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property." 11 U.S.C. § 506(a). The creditor's interest in property of the estate may arise by a valid security interest, mortgage, statutory lien, or judicial lien.

If the creditor is "oversecured," *i.e.*, if the value of its collateral exceeds the amount of its claim on the petition date, then the creditor may be entitled to have allowed, as part of its secured claim, post-petition "interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which the claim arose." 11 U.S.C. § 506(b).

If, on the other hand, the value of the collateral is less than the amount of the claim, *i.e.*, if the creditor is "undersecured," the creditor is treated as holding both (i) a secured claim up to the value of the collateral, and (ii) "an unsecured claim to the extent that the value of such creditor's interest … is less than the amount of such allowed claim." Id. The debtor may cure existing defaults under its plan, and may decelerate the debt to the extent it was accelerated pre-petition. See In re Colvin, 57 B.R. 299 (Bankr. D. Utah 1986). Through its plan, the debtor also may "strip down" an undersecured creditor's lien. In effect, the debtor is able to bifurcate the secured creditor's claim into two parts: (i) a secured claim in the amount of the value of the collateral, which must be paid in full under the plan, together with a market rate of interest; and (ii) an unsecured claim for the amount by which the creditor's pre-petition claim exceeds the value of the collateral, which will be paid *pro rata* with other unsecured claims. This treatment, however, is limited in two different contexts in a chapter 13 case, as described below. See 11 U.S.C. §§ 1322(b)(2) and 1325(a).

The debtor also may use the plan to "strip off" the liens of junior lienholders to the extent there is no equity in the "collateral" to support such creditor's lien. Such claim will not be treated as a secured claim under the plan, but will be treated and paid as a wholly unsecured claim.

Copyright © 2012 Matthew M. Boley
All rights reserved

Finally, if the collateral is sold or otherwise liquidated by the chapter 7 trustee, the secured creditor is entitled to receive the proceeds of the collateral, up to the amount of the secured creditor's claim. Further, the creditor has the right to credit bid the amount of its claim for the purchase of the collateral, pursuant to section 363(k) of the Bankruptcy Code.

7. Protection of Mortgagees in Chapter 13

Chapter 13 generally permits a debtor to "modify the rights of holders of secured claims." 11 U.S.C. § 1322(b)(2). This includes the right to bifurcate and/or "strip down" a secured claim. A chapter 13 debtor may not, however, modify the rights of the holder of "a claim secured only by a security interest in real property that is the debtor's principal residence." In short, a chapter 13 debtor cannot "strip down" the secured claim of a mortgage secured by their principal residence. Nobelman v. American Savs. Bank, 508 U.S. 324 (1993).

This protection will not apply, however, where the mortgagee's claim is, in truth, wholly unsecured. In order to qualify for the protections of section 1322(b), the claims must be secured, at least in part, by the principal residence. See Pierce v. Beneficial Mortg. Co. (In re Pierce), Adv. Pro. No. 01-2367, Bankr. Lexis 11473, at *1 (Bankr. D. Utah May 8, 2002) (holding that creditor holding a lien interest in the debtor's principal residence was properly treated as an unsecured creditor, and did not hold a secured claim, because there was insufficient equity in property to allow any payment to such creditor); Zimmer v. PSB Lending Corp. (In re Zimmer), 313 F.3d 1220 (9th Cir. 2002) (same).

8. Reaffirmation and Redemption

a. Statement of Intention

Under section 521(a)(2)(A) of the Bankruptcy Code, if an individual debtor has consumer debts secured by property of the estate, then by the earlier of thirty days after the petition date or before the date of the meeting of creditors, the debtor must file a statement of intent with respect to such property. More specifically, the debtor must "specify[] that such property is claimed as exempt," and must state whether he or she "intends to redeem such property, or that the debtor intends to reaffirm debts secured by

Copyright © 2012 Matthew M. Boley Last Updated Aug. 19, 2012
All rights reserved

such property." 11 U.S.C. §§ 521(a)(2)(A); see also 11 U.S.C. §§ 522 (exemptions), 722 (redemption), and 524(c) and (d) (reaffirmation); Colman v. Wendover Funding, Inc., No. 95-8051, 1996 U.S. App. LEXIS 14251, at *11-12 (10th Cir. June 12, 1996). Within thirty days after the date first set for the meeting of creditors, "the debtor shall perform his intention with respect to such property." 11 U.S.C. § 521(a)(2)(B).

Prior to the 1995 amendments, these provisions had no teeth. Arguably, a debtor's failure to comply with the requirements of former section 521(2) may have provided "cause" for dismissal under section 707(a) or "cause" for granting relief from the automatic stay under section 362(d)(1). Unfortunately, however, a "debtors' failure to comply fully with [former] § 521(2) d[id] not give a secured creditor an automatic right to repossess collateral." Lowry Fed. Credit Union v. West, 882 F.2d 1543, 1546 (10th Cir. 1989).

Indeed, although some courts applying the old law held that a debtor must choose between surrender, reaffirmation, or redemption of collateral, see, e.g., In re Edwards, 901 F.2d 1383, 1387 (7th Cir. 1990) (debtor must reaffirm or redeem to keep property), the Court of Appeals for the Tenth Circuit has held that a debtor may continue making payments and retain collateral without redemption or reaffirmation if the debtor has remained current on the obligation. See Lowry Fed. Credit Union, 882 F.2d at 1547 (10th Cir. 1989) ("[A]lthough we regard as mandatory the provisions of Code § 521(b), we do not believe those provisions make redemption or reaffirmation the exclusive means by which a bankruptcy court can allow a debtor to retain secured property. When the state of the evidence indicates neither the debtor nor the creditor would be prejudiced, a bankruptcy court may allow retention conditioned upon performance of the duties of the security agreement as a condition of retention.").

b. Congress Eliminated the "Ride Through" as to a Purchase Money Security Interest in Personal Property

By the 1995 amendments, Congress has statutorily overruled the "ride through" allowed by the Tenth Circuit in Lowry Fed. Credit Union v. West, 882 F.2d 1543 (10th Cir. 1989), but only in chapter 7 cases and only with respect to a purchase money security interest in personal property.

Copyright © 2012 Matthew M. Boley
All rights reserved

Section 521(a)(6) of the Bankruptcy Code now provides:

> in a case under chapter 7 of this title in which the debtor is an individual, [the debtor shall] not retain possession of personal property as to which a creditor has an allowed claim for the purchase price secured in whole or in part by an interest in such personal property unless the debtor, not later than 45 days after the first meeting of creditors under section 341(a), either—
>
> > (A) enters into an agreement with the creditor pursuant to section 524(c) with respect to the claim secured by such property; or
> >
> > (B) redeems such property from the security interest pursuant to section 722.
>
> If the debtor fails to so act within the 45-day period …, the stay under section 362(a) is terminated with respect to the personal property of the estate or of the debtor which is affected, such property shall no longer be property of the estate, and the creditor may take whatever action as to such property as is permitted by applicable nonbankruptcy law, unless the court determines on the motion of the trustee filed before the expiration of such 45-day period, and after notice and a hearing, that such property is of consequential value or benefit to the estate, orders appropriate adequate protection of the creditor's interest, and orders the debtor to deliver any collateral in the debtor's possession to the trustee.

11 U.S.C. § 521(a)(6).

c. Reaffirmation

Subsections (c), (d) and (k) of section 524 of the Bankruptcy Code govern reaffirmation agreements. Provided that certain requirements are satisfied, the debtor can enter into a binding agreement to "reaffirm" particular debts. If effective, the "reaffirmed" debt, as modified by the agreement, will survive the discharge.

To be effective, however, a reaffirmation agreement must satisfy the following requirements. First, it must be in writing. Second, the agreement must be made and entered into *before* the debtor receives his or her discharge. See 11 U.S.C. § 524(c)(1). Third, the debtor must "receive[] the disclosures described in subsection (k) at or before the time at which the debtor signed the agreement." 11 U.S.C. § 524(c)(2). These

Copyright © 2012 Matthew M. Boley
All rights reserved

mandatory disclosures are very numerous and lengthy—spanning approximately five pages of text. Fourth, the agreement must be filed with the Court. See 11 U.S.C. § 524(c)(3). Finally, the agreement must be either: (i) accompanied by a declaration or affidavit of an attorney representing the debtor stating (a) that the attorney represented the debtor during the negotiation of the agreement, (b) that the agreement represents a fully informed and voluntary agreement of the debtor, (c) that the agreement does not impose undue hardship on the debtor or the debtor's dependents, and (d) that the attorney has fully advised the debtor of the legal effect and consequences of entering the agreement and of a default under the agreement, see 11 U.S.C. § 524(c)(3); (ii) approved by the bankruptcy court as (a) not imposing an undue hardship on the debtor or the debtor's dependents, and (b) in the best interest of the debtor, see 11 U.S.C. § 524(c)(6)(A); or (iii) an agreement for reaffirmation of a consumer debt secured by real property, see 11 U.S.C. § 524(c)(6)(B).

Even if the reaffirmation agreement satisfies all of the requirements stated above, so as to be effective, however, the debtor may rescind the reaffirmation agreement "at any time prior to discharge or within sixty days after such agreement is filed with the court, whichever occurs later, by giving notice of rescission to the holder of such claim." 11 U.S.C. § 524(c)(4).

d. Redemption

Pursuant to section 722 of the Bankruptcy Code, if an individual debtor has sufficient funds available, he or she may "redeem tangible personal property intended primarily for personal, family or household use from a lien securing a dischargeable consumer debt, if such property is exempted under section 522 [of the Bankruptcy Code] or has been abandoned under section 554 …, by paying the holder of such lien the amount of the allowed secured claim of such holder that is secured by such lien in full at the time of redemption." 11 U.S.C. § 722.

Further, pursuant to Bankruptcy Rule 6008, "upo[n] motion by the debtor, trustee, or debtor in possession and after hearing on notice as the court may direct, the [bankruptcy] court may authorize the redemption of property from a lien or from a sale to

Copyright © 2012 Matthew M. Boley
All rights reserved

enforce a lien in accordance with applicable law." Fed. R. Bankr. Pro. 6008. In this respect, the debtor may exercise redemption rights available under state law.

Consequently, if the debtor has funds available, the debtor can choose to pay the amount of the secured claim and keep the property, as an alternative to reaffirmation. A practical problem for redemption, however, is the fact that the debtor rarely has sufficient funds available to redeem the property and, as a result, is forced to seek a reaffirmation of the debt.

Finally, the 1995 amendments clarified that the value of a secured claim and, therefore, the price of redeeming collateral, will always be based on the "replacement value" of the property, without deducting costs of sale or marketing. Further, if the property was acquired for personal, family or household purposes, then the replacement value will be the retail price for property of similar age and condition. See 11 U.S.C. § 506(a)(2).

Copyright © 2012 Matthew M. Boley
All rights reserved