

# MONTANA LAND AND TITLE ASSOCIATION

Fall Seminar: November 7 & 8, Billings MT

## *Disposition of Real Property in Bankruptcy for Title Agents*

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- I. Why do People file Bankruptcy
  - A. Total household debt in US August 2023, 17.06 trillion;<sup>1</sup>
    1. Credit card balance in US August 2023, 1.03 trillion;
    2. Total mortgage debt, 12 trillion;
    3. Student loan debt, 1.57 trillion;
    4. Auto loans, 1.5 trillion;<sup>2</sup> and
    5. Balance, misc. debt.
  - B. Closer look.
    1. Average credit card balance \$5,733 (August 2023).
    2. Average car payment new vehicle \$725.
    3. Interest rates on auto loans.
  - C. Debt – Voluntary & Involuntary
    1. Voluntary, promises to pay – credit card, promissory notes, deed of trust
    2. Involuntary – judgment, statutory liens, (construction liens)
  - D. Collection
    1. Wage garnishment
    2. Foreclosure and enforcement of voluntary & involuntary interests
      - a. Voluntary – Deed of Trust, Mortgage
      - b. Involuntary – Judgment, Construction Lien
  - E. Bankruptcy stops enforcement (collection)
    1. Wage garnishment – stop
    2. Trustee’s Sale scheduled in a week – stop
    3. Pending lawsuit in justice court on credit card – stop

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<sup>1</sup> <https://www.newyorkfed.org/newsevents/news/research/2023/20230808>

<sup>2</sup> <https://www.cnbc.com/2023/08/11/why-americans-are-struggling-with-car-loans.html>

## II. What is Bankruptcy, generally?

- A. Bankruptcy law is federal law.
  - 1. Article I, Section 8, of the United States Constitution authorizes Congress to enact “uniform Laws on the subject of Bankruptcies.”
  - 2. Congress enacted the “Bankruptcy Code” in 1978.
  - 3. Amended in 1984; added Chapter 12 in 1986; reformed in 1994; Substantial amendments in 2005.
- B. Bankruptcy courts are units of the District Courts. By order all bankruptcy matters are referred to the bankruptcy court.
- C. “Critical features of every bankruptcy proceeding are the exercise of exclusive jurisdiction [by the bankruptcy court] over all the debtor’s property, the equitable distribution of that property among the debtor’s creditors, and the ultimate discharge that gives the debtor a ‘fresh start’ by releasing him, her, or it from further liability for old debts.” *Cent. Va. Cmty. College v. Katz*, 546 U.S. 356, 363–364 (2006).
- D. The fresh start may follow liquidation or reorganization, and the path to a fresh start varies depending on a debtor’s eligibility for relief under different chapters – 7, 11, 12, and 13
- E. Rather than dealing with multiple creditors on a piecemeal basis, bankruptcy brings all the claims against debtor into a singular forum for a collective adjudication
  - 1. Claims against debtor are often greater than debtor’s “ability” to repay, or greater than “available property” to satisfy
  - 2. Bankruptcy Code establishes rules for who gets paid first, last, or not at all
  - 3. Source of creditor payments
    - a. “wages,” or cash flow;
    - b. Sale of property – particularly important to this group!
      - i. Who has authority to sell real property during bankruptcy, Debtor or Trustee?
      - ii. What does this “free and clear” language in the court’s order mean?

- iii. How do I disburse proceeds, where do excess proceeds go?
- iv. What in the world does this order mean, is this judge literate, this makes no sense.

*We will answer these questions.*

### III. Bankruptcy Basics for Title Agents

- A. Kinds of Bankruptcy
  - 1. Liquidating i.e., Chapter 7
  - 2. Reorganizing: i.e., Chapters 11, 12, and 13
    - a. Chapter 11 = Reorganization for a business
    - b. Chapter 12 = Reorganization for a family farmer or family fisherman
    - c. Chapter 13 = Individual or family reorganization.
  - 3. Plan of reorganization – may involve the sale of assets to pay creditors
    - a. Secured creditors get paid first
    - b. Administrative and Priority claims, next
    - c. Unsecured creditors get anything leftover
    - d. Equity holder – i.e., equity holders if the debtor is an entity, or the individual gets any remaining funds (rare occurrence).
- B. What happens during Bankruptcy?
  - 1. Petition for (voluntary) Bankruptcy – Debtor files a petition with the federal court, starts the process.
    - a. Prepetition world
    - b. Post petition world
  - 2. Immediate results of filing a bankruptcy petition
    - a. Creates Bankruptcy Estate – “all legal or equitable interest of the debtor in property as of the commencement of the case.” § 541(a) among other property – “**Bucket**”
    - b. Automatic Stay – 11 USC § 362– Subject to limited exceptions – all efforts to collect debt or enforce interests in debtor’s property must stop – “**Lid**”
  - 3. Case Administration
    - a. No asset chapter 7 case – no property to liquidate, nothing to disburse, no claims filed

- b. Asset chapter 7 case – sort through property in bucket, and sell any property that will generate proceeds to pay claims filed by creditors
- c. Reorganization cases propose plans that provide for how property will be disposed of and claims paid.
  - i. Plan might propose sale of property to pay filed claims
  - ii. Plan might propose that debtor retain property and pay filed claims with wages, or cash flow from operations
  - iii. When confirmed (confirmation order) plan is binding on debtor and debtor’s creditors
- d. In cases where claims will be paid, claims allowance process.
- e. Discharge (not focus today, but important concept).
- 4. Disposition of **real property** in the Bucket and how it might intersect with one of you. Five scenarios:
  - a. Undersecured, (or aggregate lien amounts exceed value of property) nothing to gain by liquidation in bankruptcy – Trustee Sale Guarantee/Litigation Guarantee – completion of foreclosure post stay relief.
  - b. Value of property greater than liens and liquidation will generate proceeds to pay allowed secured claims – title commitment ordered, sale to third party, payment of allowed secured claims at closing.
  - c. Valuation dispute, liquidation will generate proceeds to pay some secured claims not others. Dispute over validity and priority of lien claimants – title commitment ordered and utilized to assess lien priority. Subject to litigation, sale authorized pursuant to 363(b) and (f).
  - d. Property subject to judgment liens that impair Debtor’s homestead exemption – should order title work
  - e. Property has underground gas tanks, or other unknown liability associated with it – abandoned, no title work

*Lets look at these examples more carefully.*

IV. Fully secured nothing for estate to gain by liquidation in Chapter 7

1. Creditor will seek stay relief – permission to take the lid off the bucket and complete any “prepetition” enforcement of its interests
2. Relief is requested by motion, rarely opposed because property has no benefit to estate
3. Slide 23
4. Parsons Motion to Modify Stay & Order, **Exhibit 1**

B. Reorganization chapters, 11, 12, and 13

1. Important to ongoing operations in 11 and 12, debtor may propose that it retain property and “restructure repayment,” obligation.
2. Debtor’s residence in 13, propose to pay regular payments as the payments come due, and repay any prepetition arrearage through “plan.”
3. Alternatively, not necessary for operations or residence, same as 7, creditor will get permission to enforce interest.

V. Value of estate property greater than liens and liquidation will generate proceeds to pay allowed secured claims – title work ordered

- A. Property has value of \$600,000. Offer to buy at \$599,000. Property encumbered by Deed of Trust, \$225,000; Construction Lien, \$100,000; and Judgment Lien \$50,000. No validity or priority dispute between Deed of Trust and Construction Lien. Construction Lien is junior to Deed of Trust. Sale will generate sufficient proceeds to pay all allowed secured claims.
- B. Chapter 7 Trustee will sell this real property pursuant to § 363(b), which provides the estate may sell property “other than in the ordinary course of business,” after “notice and hearing.”
- C. Notice and hearing – hearing only required if party objects. Otherwise, sale may be completed without court order.

1. If there is an objection, court will hold hearing and enter order approving or denying sale.
2. Seller is “Estate,” acting through Trustee, or “Debtor in Possession.”
  - a. Chapter 7, Trustee
  - b. Chapter 11, Debtor in Possession, or Trustee
  - c. Chapter 12 or 13, Debtor in Possession or Trustee
3. Slide 26
4. Kennedy Order, **Exhibit 2**
5. Goodwin Motion and Order, **Exhibit 3**

V. Value of property greater than liens and liquidation will generate proceeds to pay filed claims, but there is a dispute over priority between lien claimants or the validity of a lien – title work ordered

A. Property has value of \$600,000. Offer to buy at \$599,000. Property encumbered by Deed of Trust, \$225,000; Construction Lien, \$100,000; and Judgment Lien \$50,000. Validity and priority dispute between Deed of Trust and Construction Lien.

B. 11 U.S.C. § 363(b) often read in conjunction with subsection (f), which outlines circumstances under which a sale may be free and clear. It states:

The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only 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.

C. In our scenario, there are two applicable subsections:

1. Subsection 3, Total sales price greater than all liens
2. Subsection 4, “bona fide dispute”, construction lien priority question – does construction lien have priority over deed of trust?
3. Sales may be authorized and close, subject to outcome of lien priority dispute.
4. Sale is approved, with all valid liens and claims attaching to the proceeds of the sale . . . . .
5. Slide 27
6. Parsons Sale Motion and Order, **Exhibit 4**

D. Alternative authorization for sale, “pursuant to a confirmed plan.”

1. In MT, debtors in chapter 11, 12 and 13, confirm plans of reorganization that include “sale of real property.”
  - ii. Sale may be authorized by order confirming plan.
  - ii. Language in plan is important because if real property reverts in debtor at “confirmation” seller is debtor, not estate, or debtor in possession.
  - iii. Some sale plans, sale is pursuant to § 363. In other sales plans, sale is pursuant to confirmation order.
2. Chapter 11 Order (Fortune) explaining sale distinctions, **Exhibit 5**
3. Chapter 12 Order (Oehlke & Winkowitsch) explaining sale distinctions, **Exhibit 6**

4. Chapter 13 Order (Robinson Brazee) explaining sale distinctions, **Exhibit 7**

VII. Property is fully encumbered, has underground gas tanks, or other unknown liability associated with it – abandoned, no title work

A. 11 U.S.C. § 554(a):

(a) After notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate.

(b) On request of a party in interest and after notice and a hearing, the court may order the trustee to abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate.

(c) Unless the court orders otherwise, any property scheduled under section 521(a)(1) of this title not otherwise administered at the time of the closing of a case is abandoned to the debtor and administered for purposes of section 350 of this title.

(d) Unless the court orders otherwise, property of the estate that is not abandoned under this section and that is not administered in the case remains property of the estate.

B. Slide 30, Skolrud Motion & Order, **Exhibit 8**

VIII. Property subject to judgment liens that impair Debtor’s homestead exemption – should order title work

A. Exempt property – Homestead

1. Under Bankruptcy Code, Debtors may “exempt” value of certain property, which puts that “value” beyond the reach of Trustee. Value not available to pay creditors’ claims.

2. Homestead – Mont. Code Ann. § 70-32-101

a. Pre-May 2021, \$250,000

b. Post May 2021, formula that increases 4% each year

B. Motion to Avoid Judicial Lien & Order

1. Statutory formula for determining impairment
2. If judicial lien prevents debtor from realizing full value of homestead exemption it is subject to being avoided
3. Short hand calculation – If judicial lien is less than “A,” using  $A = [B+C+D] - E$ , judicial lien is avoided in its entirety

C. Application of Formula in Example

1. B is \$44,699.40
2. C is \$348,018.89
3. D is \$250,000
4. E is \$465,000
5.  $A = \$177,718.29$

D. Slide 31–33, Douglas Motion and Order, **Exhibit 9**