

CHAPTER XXVI

BANKRUPTCY



STANDARD 26.1

EFFECT OF COMMENCEMENT OF BANKRUPTCY CASE ON DEBTOR'S INTEREST IN REAL PROPERTY

STANDARD: UPON THE COMMENCEMENT OF A BANKRUPTCY CASE, ALL LEGAL AND EQUITABLE INTERESTS OF THE DEBTOR IN REAL PROPERTY BECOME PROPERTY OF THE DEBTOR'S BANKRUPTCY ESTATE.

Problem A: Robert Holmes, the owner of Whiteacre, filed a bankruptcy petition. Does Holmes's interest in Whiteacre become property of his bankruptcy estate?

Answer: Yes.

Problem B: Robert Worden and Lynn Worden, husband and wife, owned Whiteacre as tenants by the entireties. Robert Worden filed a bankruptcy petition. Does Robert Worden's interest in Whiteacre become property of his bankruptcy estate?

Answer: Yes.

Problem C: William Jones, a land contract vendee of Whiteacre, filed a bankruptcy petition. Does Jones's interest in Whiteacre become property of his bankruptcy estate?

Answer: Yes.

Problem D: James Smith, a land contract vendor of Whiteacre, filed a bankruptcy petition. Does Smith's interest in Whiteacre become property of his bankruptcy estate?

Answer: Yes.

Authorities: Generally and Problem A: 11 USC 541(a).

Problem B: 11 USC 522(b)(3)(B). *Liberty State Bank and Trust v Grosslight*, 757 F2d 773 (CA 6, 1985); *In re Trickett*, 14 BR 85 (Bankr WD Mich, 1981).

Problem D: 11 USC 541(d).

Comment A: The answer to Problem A would be the same if the bankruptcy debtor were a corporation, general partnership, limited partnership, limited liability company, limited liability partnership or other entity eligible to be a debtor in a bankruptcy case under 11 USC 109.

Comment B: Under 11 USC 522(b)(3)(B), a debtor may elect to exempt from the bankruptcy estate the debtor's interest in real property held as a tenant by the entirety or a joint tenant to the extent the debtor's interest is exempt from process under applicable non-bankruptcy law.

Comment C: This Standard does not address whether and in what circumstances real property owned as tenants by the entirety may be sold in a bankruptcy case. See, authorities cited for Problem B.

STANDARD 26.2

EFFECT OF COMMENCEMENT OF BANKRUPTCY CASE ON FORECLOSURE OF MORTGAGE OR LAND CONTRACT

STANDARD: AFTER COMMENCEMENT OF A BANKRUPTCY CASE OF A MORTGAGOR OR LAND CONTRACT VENDEE, ANY ACT BY THE MORTGAGEE OR LAND CONTRACT VENDOR TO COMMENCE OR CONTINUE A FORECLOSURE OF THE MORTGAGE OR LAND CONTRACT OR PROCEEDINGS TO RECOVER POSSESSION OF THE REAL PROPERTY IS STAYED. ANY SUCH ACT TAKEN AFTER COMMENCEMENT OF A BANKRUPTCY CASE IS VOID.

Problem A: Robert Brown mortgaged Blackacre to Edward Lane. Lane commenced a judicial action to foreclose the mortgage. After a judgment of foreclosure was entered, but before the foreclosure sale, Brown filed a bankruptcy petition. May the foreclosure sale be held?

Answer: No.

Problem B: Same facts as in Problem A, except that the foreclosure sale was held before the bankruptcy petition was filed. Does the filing of the petition affect the validity of the foreclosure sale?

Answer: No.

Problem C: Same facts as in Problem A, except that the foreclosure sale was held after Brown's bankruptcy petition was filed. Is the foreclosure sale void?

Answer: Yes.

Authorities: 11 USC 362. *In re Glenn*, 760 F2d 1428 (CA 6, 1985).

Comment: The filing of a bankruptcy petition after a foreclosure sale will not toll the statutory redemption period. *In re Glenn, supra*. However, in that

circumstance, the statutory redemption period is extended such that the redemption period will not expire sooner than the 60th day after the filing date. 11 USC 108(b).

Caveat: Any act to commence or continue a foreclosure of a mortgage or land contract or to recover possession of real property of a bankruptcy estate occurring after a bankruptcy petition is filed is valid if the foreclosing party obtained relief from the automatic stay before the act or obtained an annulment of the automatic stay after the act. 11 USC 362(d).

STANDARD 26.3

EFFECT OF COMMENCEMENT OF BANKRUPTCY CASE ON FORFEITURE OF LAND CONTRACT

STANDARD: AFTER COMMENCEMENT OF A BANKRUPTCY CASE OF A LAND CONTRACT VENDEE, ANY ACT BY THE VENDOR TO COMMENCE OR CONTINUE A FORFEITURE OF THE LAND CONTRACT OR PROCEEDINGS TO RECOVER POSSESSION OF THE REAL PROPERTY IS STAYED. ANY SUCH ACT TAKEN AFTER COMMENCEMENT OF A BANKRUPTCY CASE IS VOID.

Problem: Edward Lane sold Blackacre to Robert Brown by land contract. Lane forfeited the land contract and commenced summary proceedings to recover possession of Blackacre. Brown filed a bankruptcy petition. After the filing, Lane obtained entry of a judgment of possession. Is the judgment of possession void?

Answer: Yes.

Authority: 11 USC 362.

Comment A: The Committee expresses no opinion as to whether the mandatory waiting period under the Summary Proceedings Act, MCL 600.5701, *et seq.*, from the entry of a judgment of possession until the issuance of an order of eviction, is tolled when a bankruptcy petition is filed by the land contract vendee. The Committee also expresses no opinion as to the effect of a bankruptcy case of a land contract vendee on the right of the vendor to retake possession of real property by self-help.

Comment B: If the mandatory waiting period under the Summary Proceedings Act, *supra*, would expire within 60 days after the filing of a bankruptcy case by the land contract vendee, the mandatory waiting period is extended such that the mandatory waiting period will not expire sooner than the 60th day after the bankruptcy filing. 11 USC 108(b).

Caveat: Any act to commence or continue a forfeiture of a land contract or to recover possession of real property of a bankruptcy estate occurring

after the filing of a bankruptcy petition is valid if the vendor obtained relief from the automatic stay before the act or obtained an annulment of the automatic stay after the act. 11 USC 362(d).

STANDARD 26.4

EFFECT ON INTEREST OF LAND CONTRACT VENDEE OF REJECTION OF LAND CONTRACT IN BANKRUPTCY CASE OF LAND CONTRACT VENDOR

STANDARD: IF A LAND CONTRACT IS REJECTED IN THE BANKRUPTCY CASE OF THE VENDOR UNDER 11 USC 365(a), THE LAND CONTRACT VENDEE IN POSSESSION OF THE REAL PROPERTY MAY ELECT TO TREAT THE LAND CONTRACT AS NOT TERMINATED AND REMAIN IN POSSESSION. IF THE VENDEE SO ELECTS, THEN:

- (A) THE VENDEE MUST CONTINUE TO MAKE ALL LAND CONTRACT PAYMENTS, REDUCED BY POST-REJECTION DAMAGES CAUSED BY NON-PERFORMANCE OF THE VENDOR'S LAND CONTRACT OBLIGATIONS; AND
- (B) THE DEBTOR (OR TRUSTEE) MUST CONVEY TITLE TO THE REAL PROPERTY TO THE VENDEE IN ACCORDANCE WITH THE LAND CONTRACT BUT IS RELIEVED OF ALL OTHER LAND CONTRACT OBLIGATIONS.

IF THE VENDEE ELECTS TO TREAT THE REJECTED CONTRACT AS TERMINATED OR IS NOT IN POSSESSION AT THE TIME OF REJECTION, THE VENDEE RETAINS A LIEN ON THE DEBTOR'S INTEREST IN THE REAL PROPERTY IN THE AMOUNT OF THE PURCHASE PRICE PAID.

Problem A: Waldo Smith purchased Whiteacre on land contract. Later, the vendor, Elwood Jones, filed a bankruptcy petition. The land contract was rejected by Jones's bankruptcy trustee while Smith was in possession of Whiteacre. May Smith elect to treat the land contract as not terminated and remain in possession of Whiteacre?

Answer: Yes.

Problem B: Same facts as in Problem A, except that Smith was not in possession of Whiteacre, nor did Smith have any right to possession of Whiteacre. May Smith elect to treat the land contract as not terminated?

Answer: No, but Smith retains a lien on the interest of Jones in Whiteacre in the amount of the purchase price paid.

Authorities: Problem A: 11 USC 365(i).

Problem B: 11 USC 365(j).

Comment A: In bankruptcy, a land contract governed by Michigan law is treated as an executory contract that may be assumed or rejected by a bankruptcy trustee under 11 USC 365(a). *In re Terrell*, 892 F2d 469 (CA 6, 1989).

Comment B: The Committee expresses no opinion as to whether a land contract purchaser who has a right to possession, but does not have actual possession of the real property, may elect to treat the land contract as not terminated and continue making payments under the land contract pursuant to 11 USC 365(i).

STANDARD 26.5-1

SALE OR LEASE OF REAL PROPERTY BY BANKRUPTCY TRUSTEE OR DEBTOR IN POSSESSION IN ORDINARY COURSE OF BUSINESS

STANDARD: A SALE OR LEASE OF REAL PROPERTY BY A BANKRUPTCY TRUSTEE OR DEBTOR IN POSSESSION IN THE ORDINARY COURSE OF THE DEBTOR'S BUSINESS, WITHOUT NOTICE TO CREDITORS OR ORDER OF THE BANKRUPTCY COURT, CONVEYS TITLE TO A PURCHASER OR LESSEE.

Problem A: Keystone Development Company was engaged in the business of purchasing, subdividing and selling real property as residential building lots. Keystone filed a voluntary petition under Chapter 11 of the Bankruptcy Code and was operating its business as a debtor in possession. Keystone sold a residential building lot to Brown. No notice of the sale was given and no order approving the sale was obtained. Did Brown acquire title to the lot?

Answer: Yes.

Problem B: Same facts as in Problem A, except that Keystone owned a shopping center in which it leased retail space. Keystone leased retail space in the shopping center to Green. Did Green acquire a leasehold interest?

Answer: Yes.

Authority: 11 USC 363(c)(1).

Comment: A debtor in possession or a trustee may not sell or lease property in the ordinary course of business unless operation of the business is authorized by the Bankruptcy Code or by an order of the Bankruptcy Court. Unless the Bankruptcy Court orders otherwise, the debtor in possession or the trustee in a Chapter 11, 12 or 13 bankruptcy case is authorized to operate the debtor's business. 11 USC 1108, 11 USC 1203, 1204 and 11 USC 1304(b). However, in a Chapter 7 bankruptcy case, the trustee is not authorized to operate the debtor's business unless authorized by an order of the Bankruptcy Court. 11 USC 721.

STANDARD 26.5-2

SALE OR LEASE OF REAL PROPERTY BY BANKRUPTCY TRUSTEE OR DEBTOR IN POSSESSION NOT IN ORDINARY COURSE OF BUSINESS

STANDARD: A SALE OR LEASE OF REAL PROPERTY BY A BANKRUPTCY TRUSTEE OR DEBTOR IN POSSESSION NOT IN THE ORDINARY COURSE OF THE DEBTOR'S BUSINESS CONVEYS TITLE TO A PURCHASER OR LESSEE IF:

- (A) NOTICE OF THE SALE OR LEASE IS GIVEN;
- (B) AN OPPORTUNITY FOR HEARING IS PROVIDED;
AND
- (C) EITHER:
 - (1) NO OBJECTION TO THE SALE OR LEASE IS FILED; OR
 - (2) THE SALE OR LEASE IS AUTHORIZED BY AN ORDER OF THE BANKRUPTCY COURT AFTER A HEARING.

Problem A: Howard Manufacturing Company owned Whiteacre. Howard, as a debtor in possession under Chapter 11 of the Bankruptcy Code, entered into a contract to sell Whiteacre to Robert Holmes. Howard gave notice of the sale. The notice included the time period for filing objections and a hearing date in the Bankruptcy Court if objections were filed. The notice also stated that if no objections were timely filed Howard would complete the sale to Holmes. No objections were filed and Howard completed the sale to Holmes. Did Holmes acquire title to Whiteacre?

Answer: Yes.

Problem B: Same facts as in Problem A, except that an objection to the sale was filed within the period stated in the notice. A hearing was held, pursu-

ant to which the Bankruptcy Court entered an order authorizing the sale. Did Holmes acquire title to Whiteacre?

Answer: Yes.

Authorities: 11 USC 363(b)(1). Fed. R. Bank. P. 6004.

Comment A: Fed. R. Bank. P. 6004(a) requires that notice of a proposed sale or lease of real property not in the ordinary course of business be given pursuant to Fed. R. Bank. P. 2002(a)(2), (c)(1), (i) and (k) and, if applicable, in accordance with 11 USC 363(b)(2).

Comment B: Fed. R. Bank. P. 6004(f) allows sales not in the ordinary course of business to be by private sale or public auction.

Comment C: The reversal or modification on appeal of an authorization to sell or lease real property not in the ordinary course of business will not affect the validity of the sale or lease to an entity that purchased or leased the property in good faith, whether or not the entity knew of the pending appeal, unless the authorization and the sale or lease were stayed pending appeal. 11 USC 363(m).

Caveat: The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 amended the Bankruptcy Code effective as of April 20, 2005 by adding subsection 363(d)(1) [“(d) The trustee may use, sell, or lease property under subsection (b) or (c) of this section only (1) in accordance with applicable nonbankruptcy law that governs the transfer of property by a corporation that is not a moneyed, business, or commercial corporation or trust...”]. 11 USC 363(d)(1). Consequently, a non-profit bankruptcy debtor must also comply with applicable non-bankruptcy law regulating a sale its assets.

Note: See Standard 26.5-3 for sales of real property free of liens and other interests.

STANDARD 26.5-3
SALE OF REAL PROPERTY BY BANKRUPTCY
TRUSTEE OR DEBTOR FREE AND CLEAR
OF LIENS AND OTHER INTERESTS

STANDARD: REAL PROPERTY MAY BE SOLD BY A BANKRUPTCY TRUSTEE OR DEBTOR IN POSSESSION FREE AND CLEAR OF LIENS AND OTHER INTERESTS IF THE SALE:

- (A) IS PERMITTED UNDER 11 USC 363(f);**
- (B) COMPLIES WITH THE REQUIREMENTS UNDER 11 USC 363(b)(1) OR 11 USC 363(c), AS APPLICABLE;**
- (C) COMPLIES WITH THE REQUIREMENTS OF BANKRUPTCY RULE 6004(c); AND**
- (D) IS AUTHORIZED BY AN ORDER ENTERED BY THE BANKRUPTCY COURT.**

Problem: Howard Manufacturing Company owned Whiteacre subject only to a mortgage in favor of Star Bank. Howard, as a debtor in possession under Chapter 11 of the Bankruptcy Code, entered into a contract to sell Whiteacre to Robert Holmes. The sale price exceeded the balance due on the mortgage. Howard filed a motion for authority to sell Whiteacre to Holmes free and clear of the mortgage. Howard gave notice of the motion to Star Bank and all other required parties. The notice included the time period for filing objections and the time of the hearing on the motion. Star Bank objected to the motion. At the hearing, the bankruptcy court entered an order authorizing the sale pursuant to the motion and Howard conveyed Whiteacre to Holmes. Did Holmes acquire title to Whiteacre free and clear of the mortgage?

Answer: Yes.

Authorities: 11 USC 363(f)(3). Fed. R. Bankr. P. 6004(c).

Comment A: Under 11 USC 363(f), a debtor in possession or trustee may be authorized to sell real property free and clear of a lien or other interest in the real property only if:

- (1) applicable nonbankruptcy law permits a sale of the real property free and clear of the lien or interest,
- (2) the entity holding the lien or interest consents to the sale,
- (3) as to a lien, if the sale price of the real property exceeds the aggregate value of all liens on the property,
- (4) the lien or interest is subject to a bona fide dispute, or
- (5) the entity holding the lien or interest could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of the lien or interest.

Comment B: A sale of real property under 11 USC 363(f) is subject to the adequate protection requirements of 11 USC 361 and 363(e). Typically, these requirements are satisfied in connection with a sale free and clear of liens and interests by an order approving the sale that provides that the liens and interests attach to the sale proceeds.

Comment C: Fed. R. Bank. P. 6004 sets forth the requirements for (1) filing, serving and objecting to motions to sell real property free and clear of liens and interests and (2) conducting public and private sales of real property.

Comment D: Notwithstanding the requirements of 11 USC 363(f), a trustee or debtor in possession may sell real property free and clear of any vested or contingent right in the nature of dower or curtesy. 11 USC 363(g). In that circumstance, and before consummation of the sale, the debtor's spouse has the right to purchase the real property at the price at which the real property is to be sold. 11 USC 363(i).

Comment E: Notwithstanding the requirements of 11 USC 363(f), a debtor in possession or trustee may sell both the bankruptcy estate's interest and the interest of any co-owner in real property in which the debtor had, at the time the bankruptcy case commenced, an undivided interest as a tenant in common, joint tenant or tenant by the entireties, subject to satisfaction of the requirements of 11 USC 363(h)(1) through (4).

In that circumstance, and before consummation of the sale, the co-owner of the real property has the right to purchase the real property at the price at which the real property is to be sold. 11 USC 363(i).

Comment F: “Other interests” in real property that could be the subject of a sale free and clear under 11 USC 363(f) include a leasehold interest, an easement, a restrictive covenant and a claim of adverse possession. Absent consent, the bankruptcy court will not approve a sale free and clear of such other interests unless:

- (1) applicable nonbankruptcy law permits a sale of the real property free and clear of the interest,
- (2) the interest is subject to a bona fide dispute, or
- (3) the entity holding the interest could be compelled in a legal or equitable proceeding to accept a money satisfaction of the lien or interest. 11 USC 363(f)(1), (4) and (5).

However, a party holding such an interest that is given notice of a sale free and clear of liens and other interests under 11 USC 363(f) and fails to assert the interest, object to the sale or appeal the sale order may be estopped from asserting the interest after the sale. *Gouveia v Tazbir*, 37 F3d 295 (CA 7, 1994); *Precision Industries, Inc v Qualitech Steel SBQ, LLC*, 327 F3d 537 (CA 7, 2003); *In re Mary G. Adamson*, 312 BR 16 (Bankr D Mass 2004); *Canzano v J & B Realty Trust*, 382 F3d 51 (CA 1 2004); *In re Haskell LP*, 321 BR 1 (Bankr D Mass 2005).

STANDARD 26.6

EFFECT OF COMMENCEMENT OF BANKRUPTCY CASE ON PROPERTY TAX FORECLOSURE JUDGMENT

STANDARD: A PROPERTY TAX FORECLOSURE JUDGMENT ENTERED AFTER COMMENCEMENT OF A BANKRUPTCY CASE AGAINST REAL PROPERTY OF THE BANKRUPTCY ESTATE IS VOID.

Problem: Jane Jones, the owner of Greenacre, filed a bankruptcy petition on January 10, 2007. Ad valorem real property taxes assessed against Greenacre for 2004 were unpaid. A judgment of foreclosure for the 2004 taxes was entered on February 28, 2007. Was the foreclosure judgment void?

Answer: Yes.

Authority: 11 USC 362(a).

Comment: Before enactment of 1999 P.A. 123, delinquent real property tax liens were offered at annual sales held in each county pursuant to MCL 211.60 through 211.70. A tax lien sale was void if it occurred after commencement of a bankruptcy case of the owner of the real property subject to the tax lien. See, Standards 22.1 and 22.6. If there was no purchaser at the tax lien sale, the redemption rights of the owner were terminated after notice and a hearing pursuant to MCL 211.131e. The commencement of a bankruptcy case by the owner before termination of the redemption rights operated as a stay of the termination procedure.

Caveat: Any act to commence or continue a real property tax foreclosure after a bankruptcy petition is filed is valid if the foreclosing party obtains relief from the automatic stay before performing the act or obtains an annulment of the automatic stay under 11 USC 362(d).

STANDARD 26.7

EFFECT OF BANKRUPTCY CASE COMMENCED ON OR AFTER OCTOBER 22, 1994 ON ATTACHMENT OF LIEN FOR AD VALOREM TAXES

STANDARD: A LIEN FOR AD VALOREM TAXES ATTACHES TO REAL PROPERTY THAT IS PROPERTY OF THE BANKRUPTCY ESTATE IF THE BANKRUPTCY CASE IS COMMENCED ON OR AFTER OCTOBER 22, 1994, WITHOUT REGARD TO WHETHER THE TAX LIEN DATE WAS BEFORE OR AFTER THE DATE THE BANKRUPTCY CASE WAS COMMENCED.

Problem: Jones Industries, Inc., the owner of Whiteacre, filed a Chapter 11 bankruptcy petition on November 10, 1994. The lien date for ad valorem taxes levied against Whiteacre and first becoming payable in 1994 was December 1, 1994. Did the lien for ad valorem taxes levied in 1994 attach to Whiteacre?

Answer: Yes.

Authority: 11 USC 362(b)(18).

Comment A: In addition to ad valorem property taxes, 11 USC 362(b)(18) is also applicable to a special assessment on real property imposed by a governmental unit.

Comment B: If the bankruptcy case was commenced before October 22, 1994, the lien for ad valorem taxes did not attach to the real property if the bankruptcy case was commenced before the tax lien date. For the lien date for ad valorem taxes levied before 1995, see 1994 P.A. 279 and 1994 P.A. 80.

STANDARD 26.8

EFFECT OF COMMENCEMENT OF BANKRUPTCY CASE ON UNRECORDED INTEREST IN REAL PROPERTY

STANDARD: A BANKRUPTCY TRUSTEE MAY NOT AVOID AN UNRECORDED INTEREST IN REAL PROPERTY IF THERE IS CONSTRUCTIVE NOTICE OF THE INTEREST BEFORE THE COMMENCEMENT OF THE BANKRUPTCY CASE.

Problem: John Smith deeded Whiteacre to Jane Jones. Jones entered into possession of Whiteacre. Jones did not record the deed. Later Smith filed a Chapter 7 bankruptcy petition. May the bankruptcy trustee avoid the interest of Jones in Whiteacre?

Answer: No. Jones's possession of Whiteacre constitutes constructive notice of her interest.

Authorities: 11 USC 544(a)(3). *Robbins v Lenz*, 63 BR 4 (Bankr WD Mich, 1985).

STANDARD 26.9

EFFECT OF COMMENCEMENT OF BANKRUPTCY CASE ON RIGHT TO ENFORCE ASSIGNMENT OF RENTS

STANDARD: AFTER THE COMMENCEMENT OF A BANKRUPTCY CASE, A MORTGAGEE MAY NOT INITIATE ENFORCEMENT OF AN ASSIGNMENT OF RENTS WITH RESPECT TO REAL PROPERTY OF THE BANKRUPTCY ESTATE UNLESS THE BANKRUPTCY COURT GRANTS RELIEF FROM THE AUTOMATIC STAY PROVIDED BY THE BANKRUPTCY CODE.

Problem: On October 24, 1990, Eastview Apartments Limited Partnership mortgaged its residential apartment complex to First Bank. The mortgage contained an assignment of rents. Eastview defaulted under the mortgage. Before First Bank commenced enforcement of the assignment of rents, Eastview filed a voluntary petition under Chapter 11 of the Bankruptcy Code. Was First Bank entitled to initiate enforcement of the assignment of rents without first obtaining relief from the automatic stay?

Answer: No.

Authorities: 11 USC 362(a) and 362(d).

Comment: The Committee expresses no opinion as to whether a mortgagee, who has, following default by the mortgagor, partially or fully completed the steps necessary to enforce an assignment of rents under MCL 554.231 and 554.232, acquires rights in rents and the extent of those rights under the Bankruptcy Code. *See, e.g., In the Matter of P.M.G. Properties*, 55 BR 864 (Bankr ED Mich 1983); *In the Matter of Coventry Commons Associates*, 143 BR 837 (ED Mich 1992); *In re Mount Pleasant Limited Partnership*, 144 BR 727 (Bankr WD Mich 1992); *In re Newberry Square, Inc*, 175 BR 910 (Bankr ED Mich 1994); *In re Woodmere Investors Limited Partnership*, 178 BR 346 (Bankr SD NY 1995), applying Michigan law.

