BANKRUPTCY ISSUES IN WORKOUTS AND FORECLOSURES

Presented by

Gregory G. Hesse
Lynnette R. Warman
Hunton & Williams LLP
1445 Ross Avenue, Suite 3700
Dallas, Texas 75202-2799
(214) 979-3000
(214) 880-0011 (fax)
ghesse@hunton.com
lwarman@hunton.com

Edward F. Walker
Cramer Weatherbie Richardson Walker LLP
5956 Sherry Lane, Suite 850
Dallas, Texas 75225
(214) 369-2270
(214) 361-7842
ewalker@cwrwlaw.com

TABLE OF CONTENTS

Introduction.

When Congress enacted the Bankruptcy Code in 1978, it endeavored to modernize the bankruptcy laws to more efficiently effectuate its purpose. In the legislative history, Congress identified several policies that the Bankruptcy Code was designed to foster including: (1) prevention of the dismemberment of the pre-petition debtor, (2) equality of distribution to creditors, and (3) the fresh start of debtors. *Union Bank v. Wolks*, 502 U.S. 151, 112 S.Ct. 527, 533, 116 L.Ed.2d 514 (1991) (quoting from H.R. Rep. No. 95-595, at 177-178; U.S. Code Cong. and Admin. News 1978, pp. 6137, 6138). In order to accomplish these global policies, Congress included in the Bankruptcy Code such provisions as: (1) the automatic stay to prevent creditors from dismembering the debtors, (2) the distribution scheme to provide for equal distribution to creditors of equal priority, (3) the discharge to give honest debtors a fresh start, (4) mechanisms to liquidate assets to maximize value, and (5) mechanisms to maximize the distributions to creditors. In this article, I will address the common issues in Bankruptcy cases faced by the owners of interests in real property, including the owner of fee interests, lien interests and leasehold interests.

I. Automatic Stay

A. Imposition of Automatic Stay. Upon the filing of a petition in bankruptcy (regardless of whether the petition is voluntary or involuntary), 11 U.S.C. § 362 imposes a stay of certain actions applicable to all entities. According to the legislative history of 11 U.S.C. § 362, the "automatic stay is one of the fundamental protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, and harassment and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply be relieved of the financial pressures that drove him into bankruptcy." H.R. Rep. No. 595, 95th Cong., 1st. Sess. 174-175 (1977).

B. Matters Stayed

1. The automatic stay only applies to certain specific actions set forth in 11 U.S.C. § 362(a), which section states:

> "(a) [e]xcept as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of—
>
> > (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

(3) 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;

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax court concerning the debtor."

2. While the language of 11 U.S.C. § 362 should be analyzed to determine whether a specific action is stayed, examples of actions stayed are helpful. The automatic stay of 11 U.S.C. § 362 applies to, *inter alia*, the following actions:

a. Foreclosure. *Sullivan Cent. Plaza I, Ltd. v. Banc Boston Real Estate Cap. Corp. (In the Matter of Sullivan Cent. Plaza I, Ltd.)*, 914 F.2d 731, 732 (5th Cir. 1990).

b. Continuation of lawsuits to collect debts, including the pursuit of appeals. *Sheldon v. Munford, Inc.*, 902 F.2d 7 (7th Cir. 1990); *Borman v. Raymark Indus., Inc.*, 946 F.2d 1031 (3rd. Cir. 1991); *In re Capgro Leasing Assocs.*, 169 B.R. 305, 310 (Bankr. E.D.N.Y. 1994) (eight federal circuits hold that automatic stay stops appeal pending in non-bankruptcy forum).

c. Forcible entry suits. *See In re Trang*, 58 B.R. 183 (Bankr. S.D. Tex. 1985); *In re Kilby*, 100 B.R. 579 (Bankr. W.D. Fla. 1989).

d. Lockouts by landlords. *Wyatt v. Melton Mortgage, Inc.*, 36 B.R. 783 (Bankr. S.D. Ohio 1984).

e. Setoff. *In re Missionary Baptist Foundation, Inc.*, 796 F.2d 752 (5th Cir. 1986).

f. Execution and/or sale of property. *Coats v. Vawter (In re Coats)*, 168 B.R. 159 (Bankr. S.D. Tex. 1993).

g. Repossession of Collateral. *In re Abrams*, 127 B.R. 239 (9th Cir. BAP 1991); *Thompson v. GMAC, LLC*, 566 F.3d 699, 703 (7th Cir. 2009).

3. Not all actions are stayed, however, and 11 U.S.C. § 362(b) provides a list of specific actions which are not stayed. Examples of actions not stayed include:

a. The "Administrative Freeze." The Supreme Court finally resolved the spilt among the lower courts as to whether an administrative freeze of a bank account violates the automatic stay. *Citizens Bank of Md. v. Strumpf*, 516 U.S. 16, 116 S.Ct. 268, 133 L.Ed.2d 258 (1995). According to Justice Scalia, a setoff is not effective until the bank: (i) decides to effectuate the setoff, (ii) takes some action accomplishing the setoff, and (iii) has recorded the setoff on its books. An administrative freeze merely prevents the debtor from withdrawing money from the bank account in order for the bank to retain its right of setoff, but does not reduce a debt owing to the bank. Thus, the administrative freeze is not a setoff and it does not violate the automatic stay.

b. Actions against co-debtors are generally not stayed. *GATX Aircraft Corp. v. M/V Courtney Leigh*, 768 F.2d 711 (5th Cir. 1985). However, if a case is pending under Chapter 13, 11 U.S.C. § 1301 imposes a stay of collection against co-debtors of consumer debt in certain circumstances.

c. Actions against guarantors are generally not stayed. *Browning Sed, Inc. v. Bayles*, 812 F.2d 999 (5th Cir. 1987); *Edwards v. Armstrong World Indus*, 6 F.3d 312 (5th Cir. 1993).

d. Actions against a general partner of debtor partnerships are generally not stayed. *Patton v. Bearden*, 8 F.3d 343 (6th Cir. 1993).

e. Actions against co-defendants are generally not stayed. *Marcus, Stowel & Beye Gov. Securities Inc. v. Jefferson Inv. Corp.*, 797 F.2d 227 (5th Cir. 1986). *Wedgeworth v. Fiberboard*, 706 F.2d 541 (5th Cir. 1983).

f. Actions by government units to enforce regulations to promote health and safety are not stayed. *Brock v. Marysville Body Works, Inc.*, 829 F.2d 383 (3rd Cir. 1987).

g. Actions by government units to enforce environmental laws are not stayed. *In re Commonwealth Oil Refining Co.*, 805 F.2d 1175 (5th Cir. 1986).

h. Civil enforcement proceedings brought by a governmental unit and enforcement of injunctive relief obtained therein are exempted from the automatic stay. *SEC v. First Fin. Group of Tex.*, 645 F.2d 429 (5th Cir. 1981).

i. Actions by the Federal Reserve Board charging debtor with violations of Board's "source of strength" regulation and violations of Federal Reserve Act are not stayed. *Bd. of Governors of Fed. Res. Sys. v. Mcorp Fin., Inc.*, 502 U.S. 32, 112 S.Ct. 459, 116 L.Ed.2d 358 (1991).

j. Actions to modify or enforce zoning regulations are generally not subject to automatic stay. *Courmeyer v. Lincoln*, 790 F.2d 971 (1st Cir. 1986).

C. Duration of the Automatic Stay.

1. Property. The stay of an act against property of the estate continues until the property is no longer property of the estate. 11 U.S.C. § 362(c)(1).

a. Abandonment. If property is abandoned by the Trustee pursuant to 11 U.S.C. § 554, the property ceases to be property of the estate. *In re Walker*, 151 B.R. 1006 (Bankr. E.D. Ark. 1993).

b. Exemption. If an individual debtor claims the property as exempt pursuant to 11 U.S.C. § 522 and the exemption is upheld, the property ceases to be property of the estate. *In re Cureton*, 38 B.R. 279 (Bankr. D. Minn. 1984).

2. Other Acts. The stay of all other acts continues until the earliest of: (a) the time the case is closed; (b) the time the case is dismissed; or (c) the granting or denial of a discharge. 11 U.S.C. 362(c)(2).

a. If discharge is granted, the automatic stay is terminated but it is replaced by an injunction to prevent collection efforts against the debtor or its property. See 11 U.S.C. § 524(a); *Green v. Welsh*, 956 F.2d 30 (2nd Cir. 1992); *In re Barbour*, 77 B.R. 530 (Bankr. E.D. N.C. 1987); *In re Peterson*, 118 B.R. 801 (Bankr. D.N.M. 1990). *In re Jones*, 164 B.R. 543 (Bankr. N.D. Tex. 1994); *In re Shivani*, Case No. 03-30930, 2004 Bankr. LEXIS 277, at *14-*15 (Bankr. D. Conn. Mar. 11 2004).

b. Generally, the discharge will not avoid a creditor's lien. *Dewsnup v. Timm*, 502 U.S. 410, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992).

c. The denial of a discharge:

(1) If a creditor successfully objects to the discharge of a specific debt pursuant to 11 U.S.C. § 523, the automatic stay against the debtor terminates upon the entry of the order solely for the benefit of that creditor. *Boatman's Bank v. Embry (In re Embry)*, 10 F.3d 401 (6th Cir. 1993). The automatic stay as to property of the estate continues until the trustee abandons the property. Further, the automatic stay as to all remaining creditors continues.

(2) If a party successfully objects to the discharge of the debtor pursuant to 11 U.S.C. § 727, the automatic stay terminates against the debtor upon the entry of the order for the benefit of all creditors. *Teamsters Pension Trust Fund v. Malone Realty Corp.*, 82 B.R. 346 (E.D. Pa. 1988). The automatic stay as to property of the estate continues until the trustee abandons the property.

D. Relief from Automatic Stay. If a creditor wants relief from the automatic stay, the creditor must file a motion with the court. Fed. R. Bankr. P. 4001. After notice and a hearing, the court will grant the creditor relief from the automatic stay if the creditor establishes cause for modifying the automatic stay or if the creditor establishes that the debtor lacks equity in the property and the property is not necessary for an effective reorganization. 11 U.S.C. § 362(d), Fed. R. Bankr. P. 4001.

1. Cause: 11 U.S.C. § 362(d)(1) allows the automatic stay to be terminated for cause, including lack of adequate protection.

a. Adequate Protection. 11 U.S.C. § 361 provides examples of adequate protection, including:

(1) Making cash payment(s) to the lienholder for the use of property;

(2) Providing the lienholder with an additional or replacement lien;

(3) Providing the lienholder with the indubitable equivalent of its interest in the property.

b. Other Examples of "Cause." Examples of cause to grant relief from automatic stay include:

(1) Value of property in which creditor claims an interest is declining in value. *In the Matter of Newark Airport/Hotel Lim. P'ship*, 155 B.R. 93 (Bankr. D.N.J. 1993); *In re 160 Bleecker Street Assoc.*, 156 B.R. 405 (S.D.N.Y 1993).

(2) Failure to pay property taxes. *In re James River Assoc.*, 148 B.R. 790 (E.D. Va. 1992).

(3) Failure to provide insurance. *In re Jones*, 189 B.R. 13 (Bankr. E.D. Okla. 1995); *In re CGR, Ltd.*, 56 B.R. 305 (Bankr. S.D. Tex. 1985).

(4) Failure to comply with court orders. *In re CGR, Ltd.*, 56 B.R. 305 (Bankr. S.D. Tex. 1985).

c. Pre-Petition Waiver. At this time, the bankruptcy courts have split on the issue of whether pre-petition waivers of the automatic stay are enforceable and act as "cause" for granting relief from the automatic stay. Compare *In re Atrium High Point Ltd. P'ship*, 189 B.R. 599 (Banks. M.D.N.C. 1995) (pre-petition waivers are enforceable in

certain circumstances); *In re Powers*, 170 B.R. 480 (Bank. D. Mass.) (enforcing pre-petition waiver agreement of automatic stay); *In re Club Tower*, 138 B.R. 307 (Banks. N.D. Ga. 1991) (same); *In re Citadel Props., Inc.*, 86 B.R. 275 (Banks. M.D. Fla. 1988) (same) with *In re Jenkens Court Assoc. Ltd. P'ship*, 181 B.R. 33 (Banks. E.D. Pa. 1995) (refusing to enforce pre-petition waiver) *Farm Credit of Cent. Fl. v. Polk*, 160 B.R. 870 (M.D. Fla. 1993) (same); *In re Sky Group Int'l, Inc.*, 108 B.R. 86 (Banks. W.D. Pa. 1989) (same).

2. Lack of Equity and Property not Necessary for Effective Reorganization. 11 U.S.C. § 362(d)(2) allows the automatic stay to be terminated if the debtor lacks Equity in the property and the property is unnecessary for an effective reorganization:

a. Equity Before a court can grant relief from the automatic stay, the court must conclude that the debtor lacks equity in the property;

(1) Equity, as used in 11 U.S.C. § 362(d), is the difference between the value of the subject property and the total encumbrances against the property. *In re Sutton*, 904 F.2d 327 (5th Cir. 1990).

(2) Value of property is a hotly contested fact issue and the courts are split as to whether proper valuation method is liquidation value or going concern value.

b. Necessity of Property. Before a court can modify the automatic stay under 11 U.S.C. § 362(d)(2), the court must conclude that the property is not necessary for an effective reorganization;

(1) If case is a Chapter 7 liquidation, no reorganization will occur.

(2) If the case is in a reorganization chapter, the debtor must establish not only that the collateral at issue is necessary for an effective reorganization, but that there exists a reasonable possibility for a reorganization within a reasonable time. *United Sav. Assoc. v. Timbers of Inwood Forest Assoc., Ltd.*, 484 U.S. 365, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988).

3. "Single Asset Real Estate" Case. In 1994, Congress enacted special provision relating to modification of the automatic stay for "Single Asset Real Estate" debtors.

a. Definition. "Single asset real estate" debtor is defined by 11 U.S.C. § 101 (51B) as follows:

"(51B) 'single asset real estate' means real property constituting a single property or project, other than residential real property with fewer than 4 residential units, which generates substantially all of the gross income of a debtor who is not a family farmer and on which no substantial business is

being conducted by a debtor other than the business of operating the real property and activities incidental."

b. Relief From Stay in "Single Asset Real Estate" Cases. In a case relating to "single asset real estate" debtors, the procedure for obtaining relief from the automatic stay is streamlined. According to 11 U.S.C. § 362(d)(3), the automatic stay will be lifted if:

> "(3) with respect to a stay of an act against single asset real estate under subsection (a), by a creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90-day period) or 30 days after the court determines that the debtor is subject to this paragraph, whichever is later--
>
> (A) the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or
>
> (B) the debtor has commenced monthly payments that—
> a. may, in the debtor's sole discretion, notwithstanding section 363(c)(2), be made from rents or other income generated before, on, or after the date of the commencement of the case by or from the property to each creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien); and
> b. are in an amount equal to interest at the then applicable nondefault contract rate of interest on the value of the creditor's interest in the real estate"

c. Explanation. In other words, in order to obtain relief from the automatic stay in a "single asset real estate" case, all that the court must find is:

> (1) The debtor has not filed plan that has reasonable possibility of being confirmed; and
>
> (2) Debtor has not commenced monthly payments to the creditor in an amount equal to interest at the then applicable nondefault contract rate on the value of the creditor's interest in the real estate.

d. Court Interpretations. The opinions interpreting 11 U.S.C. § 362(d)(3) which relates to "single asset real estate" cases are limited. In *In re CBJ Devel., Inc.*, 202 B.R. 467 (9th Cir. B.A.P. 1996), the court held that full service hotel was not a single asset real estate

debtor. In *In re Philmont Devel. Co.*, 181 B.R. 220 (Bankr. E.D. Pa. 1995), the court emphasized that a "single asset real estate" case includes not only a multi-family property (*i.e.* apartment), but also a project with more than four "semi-detached houses." In *In re Kkemko, Inc.*, 181 B.R. 47 (Bankr. S.D. Ohio 1995) the court held that a debtor which owns and operates a marina is not a "single asset real estate" debtor because a marina does more than rent mooring space.

4. Hearing. If a hearing is not held within 30 days from the filing of the motion for relief from the automatic stay, the stay will be lifted. *In re River Hills Apartment Fund*, 813 F.2d 702 (5th Cir. 1987); *In re Orfa Corp.*, 170 B.R. 257 (E.D. Pa. 1994). The parties can agree to have a preliminary hearing within 30 days followed by a final hearing within 30 days of the preliminary hearing. However, in 1994 Congress modified 11 U.S.C. § 362(e) to clarify that the hearing on a motion for relief from the automatic stay can no longer be indefinitely extended without the agreement of all parties-in-interest, including the secured party.

5. Burden of Proof.

a. Creditor has burden of proof as to equity in the property. 11 U.S.C. § 362(g)(1); *Gateway Estates v. Bailey*, 169 B.R. 379 (E.D. Mich. 1994).

b. Party opposing relief has burden of proof as to everything else. 11 U.S.C. § 362(g)(2).

E. Penalty for Violating Automatic Stay. If an individual is injured by a willful violation of an automatic stay, he may recover actual damages and in appropriate circumstances, punitive damages. 11 U.S.C. § 362(k); *In re Crysen/Montenay Energy Co.*, 902 F.2d 1098 (2nd Cir. 1990).

F. Effect of Violating Automatic Stay. In the Fifth Circuit, violations of the automatic stay are voidable, not void, because the bankruptcy court has power to annul the stay. *In re Hipp*, 5 F.3d 109 (5th Cir. 1993); *Picco v. Global Marine Drilling Co.*, 900 F.2d 846 (5th Cir. 1990). The remaining circuits are split as to whether violations of the automatic stay are voidable, *see, e.g., In re Schwartz*, 119 B.R. 207 (9th Cir. BAP 1990) or void. *See, In re 48th Street Steakhouse, Inc.*, 835 F.2d 427 (2d Cir. 1987); *In re Smith*, 876 F.2d 524 (6th Cir. 1989); *In re Floyd*, 359 B.R. 431 (Bankr. D. Conn. 2007).

II. Claims. After the automatic stay, the next frequently considered issue is the amount creditors are owed for their pre and post-petition claims.

A. Definition of Claim. In a bankruptcy case, a debtor's obligation to a creditor is referred to as a "claim." The definition of claim is very broad and is intended to be all encompassing. Thus, pursuant to 11 U.S.C. § 101(5), "claim" is defined as

> "(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured or unsecured;"

According to the legislative history, the bankruptcy code "contemplated that all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case. It permits the broadest possible relief in the bankruptcy court." H.R. Rep. No. 595, 95th Cong. 1st Sess. 309 (1977).

B. Amount of Claim. As a general mater, the claim amount is the debtor's liability to the creditor under applicable substantive law. A debtor is obligated to file with the court schedules that list all of his creditors and the amount the creditors are owed. Fed. R. Bankr. P. 1007.

C. Proofs of Claim.

1. Necessity of Filing Proof of Claim. In cases under Chapter 7, 12 and 13, all creditors must file a proof of claim to receive distributions. Fed. R. Bankr. P. 3002. In a case under Chapter 9 or 11, only a creditor whose claim is not scheduled properly or is scheduled as disputed, contingent or unliquidated must file a proof of claim to receive distributions. Fed. R. Bankr. P. 3003.

2. Effect of Filing Proof of Claim. A proof of claim filed in accordance with the rules constitutes *prima facie* evidence of the validity and amount of claim. Fed. R. Bankr. P. 3001(f). *Lipetzky v. Dept. of Revenue (In re Lipetzky)*, 66 B.R. 648, 649 (Bankr. D. Mont. 1986); *In re Glick*, 136 B.R. 654, 656 (Bankr. W.D. Pa. 1991); *First Nat'l Bank v. Circle J. Dairy (In re Circle J. Dairy, Inc.)*, 112 B.R. 297, 299-300 (W.D. Ark. 1989). Further, a proof of claim which is filed is deemed allowed unless a party in interest files an objection to the allowability of the claim. 11 U.S.C. § 502(a). *In re Alderman*, 150 B.R. 246, 250 (Bankr. D. Mont. 1993); *In re Johnson*, 95 B.R. 197, 200 (Bankr. D. Colo. 1989) (questioned on other grounds); *In re Hermanson*, 84 B.R. 729, 734 (Bankr. D. Colo. 1988) (criticized on other grounds).

3. Objections to Proofs of Claim. An objection to the allowance of a proof of claim must be filed with the court and in writing. Fed. R. Bankr. P. 3007(a). To rebut the validity of a proof of claim, the objecting party must produce sufficient evidence to rebut the *prima facie* validity of the proof of claim. *Cal. State Board of Equalization v. Official Unsecured Creditors' Comm. (In re Fidelity Holding Co., Ltd.)*, 837 F.2d 696, 698 (5th Cir. 1988); *In re Chapman*, 132 B.R. 132, 143 (Bankr. N.D. Ill. 1991); *In re Circle J. Dairy*, 112 B.R. 297, (W.D. Ark. 1989). In 11 U.S.C. § 502(b), Congress lists several bases for objecting to a proof of claim including that the claim is unenforceable under applicable substantive (i.e., state or federal) law, including fraud, lack of consideration, statute of limitations, or statute of frauds. *In re Snidley*, 149 B.R. 128 (Bankr. D.S.D. 1992).

4. Estimation of Claims. To the extent a claim is contingent or unliquidated, the court can estimate the claim to further administration of the case. 11 U.S.C. § 502(c). *See, In re*

Continental Airlines, Inc., 57 B.R. 842 (Bankr. S.D. Tex 1985); *In re Eagle Bus Manufacturing, Inc.*, 158 B.R. 421 (Bankr. S.D. Tex. 1993). *See also, In re Continental Airlines, Inc.*, 981 F.2d 1450 (5th Cir. 1993) (claim estimation is inappropriate where claim is neither contingent nor unliquidated).

D. Subordination of the Claims. In certain circumstances, distributions to a creditor may be subordinated to distribution of other creditors.

1. Subordination Agreements. If a creditor has agreed to subordinate payment of its claim to other creditors, the subordination agreement is enforceable. 11 U.S.C. § 510(a). *In re Kors, Inc.*, 819 F.2d 19 (2nd Cir. 1987); *In re Best Products, Inc.*, 168 B.R. 35 (Bankr. S.D.N.Y. 1994).

2. Claims Arising from the Purchase of Securities. If a creditor has a claim arising from a rescission of a purchase or sale of a security of the debtor or an affiliate of the debtor, for damages arising from the purchase or sale of such a security or for reimbursement or contribution on account of such a claim, the claim is subordinated to the same priority as the claim or the interest represented by the security. 11 U.S.C. § 510(b). *In re Flight Transportation Corp.*, 730 F.2d 1128 (8th Cir. 1984).

3. Equitable Subordination. If a creditor engages in inequitable conduct, its claim may be subordinated. *In re Missionary Baptist Foundation*, 712 F.2d 206 (5th Cir. 1983). Example of inequitable conduct include: (i) fraud, illegality, breach of fiduciary duties; (ii) undercapitalization; and (iii) the claimants use of the debtor as a mere instrumentality or alter ego. *In re Mobile Steel Co.*, 563 F.2d 692 (5th Cir. 1977); *In re Herby's Foods*, 2 F.3d 128 (5th Cir. 1993); *In re Fabricators*, 926 F.2d 1458 (5th Cir. 1991).

E. Secured Claims.

1. Definition of Secured Claim. An allowed claim of a creditor secured by a lien on property in which the estate has an interest or that is subject to set off is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, and is an unsecured claim to the extent that the value of such creditors interest is less than the amount of the allowed claim. 11 U.S.C. § 506(a).

a. Undersecured Example. If a creditor is owed $500,000 on the petition date secured by real estate with a value of $300,000, the creditor has a secured claim in the amount of $300,000 and an unsecured claim in the amount of $200,000. *See Miller v. United States*, 907 F.2d 80 (8th Cir. 1990); *In re Glick*, 136 B.R. 654 (Banker. W.D.Va. 1991), *In re Etchin*, 128 B.R. 662 (Bankr. W.D. Wis. 1991).

b. Oversecured Example. If a creditor is owed $500,000 on the petition date secured by real estate with a value of $600,000, the creditor has a secured claim in the amount of $500,000. *See In re Hanna*, 912 F.2d 945 (8th Cir. 1990).

2. Valuation of Collateral. According to 11 U.S.C. § 506(a), the value of collateral shall be determined in light of the purpose of the valuation and the proposed disposition and use of the property.

a. Liquidation Value. In some instances, the courts use liquidation value. For example:

(1) Motion for relief from automatic stay.

(2) Motion to obtain secured post-petition financing under 11 U.S.C. § 364 with a lien prior to or equal to the secured creditor.

(3) Confirmation of plan of reorganization that proposes a return of the collateral to the secured creditor. *In re Simons*, 113 B.R. 942 (Bankr. W.D. Tex. 1990).

b. Going Concern Value. In some instances, the courts use going concern value. For example:

(1) Confirmation of an operating plan of reorganization. *In re Penz*, 102 B.R. 826 (Bankr. E.D. Okla. 1989); *In re Chateaugay Corp.*, 154 B.R. 29 (Bankr. S.D.N.Y. 1993).

3. Post-Petition Matters. As a general matter, a creditor is not allowed to collect post-petition interest fees or expenses from the debtor. *In re Bates*, 58 B.R. 915 (Bankr. W.D. Tenn. 1986). The exception to the general rule is when a creditor is oversecured, then 11 U.S.C. § 506(b) allows the secured creditor to collect interest and those reasonable fees, costs or charges provided for under the agreement under which such claim arose.

a. Interest. If the secured creditor is oversecured, the creditor may collect interest regardless of whether or not an agreement exists between the creditor and debtor. *See United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 109 S. Ct. 1026, 103 L. Ed. 2d 290 (1989).

b. Fees, Costs or Charges. To collect post-petition fees, costs and charges, the court must conclude that (1) creditor has an allowed secured claim; (2) the creditor is oversecured; (3) the underlying documents must provide for fees, costs or charges; and (4) the request for fees, costs and charges must be reasonable. *In re Maywood, Inc.*, 210 B.R. 91 (Bankr. N.D.Tex 1997); *In re Alpine Group, Inc.*, 151 B.R. 931 (9th Cir. BAP 1993); *In re Wire Cloth Prods., Inc.*, 130 B.R. 798 (Bankr. N.D. Ill. 1991); *In re Reposa*, 94 B.R. 257 (Bankr. D. R.I. 1988).

c. Default Interest. As a general matter, an oversecured creditor may collect interest at the default rate unless the charging of default interest would produce an inequitable or unconscionable result. *In the Matter of Laymon*, 958 F.2d 72, 75 (5th Cir.

1992), *cert. denied*, 506 U.S. 328, 113 S.Ct. 328 (1992). Therefore, the courts are to examine default interest rates on a case by case basis to determine if the default rate should be applied. *Id.*

4. Surcharge of Collateral. In certain circumstances, if the trustee or debtor in possession preserves or disposes of the property securing a creditor's claim, 11 U.S.C. § 506(c) allows the court to charge a secured creditor's collateral for the reasonable, necessary costs and expenses of preserving or disposing of collateral. *PSI, Inc. v. Aguillard (In the Matter of Senior - G&A Op. Co., Inc.*), 957 F.2d 1290, 1298 (5th Cir. 1992); *New Orleans Public Service, Inc. v. First Fed. Sav. & Loan Assoc. (In the Matter of Delta Towers, Ltd.)*, 924 F.2d 74, 76 (5th Cir. 1991). The courts, however, have not consistently held whether the trustee or the administrative claimant has standing to seek a surcharge of the secured creditor's collateral. For a more thorough discussion of standing, please *see* Hesse, *One Statute, Three Disparate Interpretations: Standing to Pursue Recovery from a Secured Creditor Pursuant to Bankruptcy Code Section 506(c)*, 47 BAYLOR L. REV. 39 (1995).

F. Assignment of Claims.

The Loan Sale Agreement attached as Exhibit A, which started life as a typical form used to convey a loan (the "Loan"). It has been adopted to provide for a springing deed of trust to secured a portion of the purchase price. The obligor of the Loan is assumed to be in Chapter 11 bankruptcy after a long series of forbearance agreements with the obligor; the seller of the Loan will finance a portion of the purchase price secured first by a security interest in the Loan in the initial stage and later by a lien in the real estate securing the Loan sold. A subordinate or junior creditor will finance a portion of the purchase price that will be similarly secured by a junior security interest in the Loan sold land then in the subsequent stage of the transaction by a junior lien in the real estate securing the Loan sold. The form is a balance or negotiated document and is not entirely one-sided in favor of the seller/senior creditor. Exhibits to the Loan Agreement have been deleted. Forms of notes, deeds of trust, security agreement, and other security documents preferred by the parties or their counsel may be used in connection with the Loan Sale Agreement.

The principal illustration to be gleaned from this form is the "springing deed of trust." It is defined in the Loan Sale Agreement as the "Purchase Money Mortgage." [Other defined terms used in this Section refer to the terms used in the Loan Sale Agreement or Escrow Agreement referred to below.] Because the obligor of the Loan being sold is in bankruptcy, an automatic stay order is in place that prohibits the recording of any liens affecting the real estate that forms a part of the debtor's estate in bankruptcy. As a result, in the first stage of the sale of the Loan, the buyer of the Loan cannot grant a lien in that real estate.

However, it can grant a purchase money security interests in the Loan sold to the buyer. See Exhibit C to the Loan Agreement. In addition, a separate Security Agreement granting a security interest in the Loan is to be executed by the buyer.

The buyer can also agreed to place the springing deed of trust or Purchase Money Mortgage into escrow pursuant to an Escrow Agreement like the one attached as Exhibit B. This Escrow Agreement provides for each of the senior creditor or seller of the Loan and the junior creditor to deposit the deeds of

trust and certain other loan documents executed by the buyer at Closing of the sale of the Loan into escrow to be held by the Escrow Agent pending lifting of the bankruptcy stay order and consummation of the deed in lieu or foreclosure of the Deed of Trust and other liens and security interests securing the Loan sold. Immediately following the transfer of title to the real estate and other collateral described in those documents to the buyer, the Escrow Agent is instructed to file the Purchase Money Deed of Trust and other documents securing the senior creditor and then those securing the junior creditor. See Section 2.1 of the Escrow Agreement.

A major concern of the creditors will be to assure that no encumbrances affect the buyer's title to the real estate that prime the Purchase Money Mortgages or springing deeds of trust. To assure that does not happen, the parties define the encumbrances that are permitted, which are referred to as the Permitted Encumbrances. See Recital E of the Escrow Agreement. The deed conveying title to the buyer may not be subject to any encumbrances other than Permitted Encumbrances, vendor's lien in favor of the senior creditor and the Purchase Money Deed of Trust. See Section 3.2(c) of the Escrow Agreement. The Escrow Agreement also provides that the deed conveying title to the buyer shall reserve a vendor's lien in favor of the senior creditor.

Not later than thirty days prior to any transfer of title, the buyer is required to have title commitments issued to the Senior and junior creditor. See Section 3.2(e) of the Escrow Agreement. Following transfer of title to the buyer and recordation of the Purchase Money Deed o f Trust and Junior Deed of Trust, the buyer is required to have loan policies of title insurances issued by a title company, which in this case is an affiliate of Escrow Agent, to the senior creditor and junior creditor. See Section 3.2(g).

These procedures have proven effective to provide the senior mortgagee creditor with a first lien deed of trust and the junior mortgagee creditor with a Junior Deed of Trust, each subject only to the Permitted Encumbrances.

III. Sale of Property.

A. Ordinary Course of Business. If the trustee or the debtor-in-possession are operating the business of the debtor, the trustee may enter into transactions in the ordinary course of business, including the sale or lease of property, without notice and a hearing. 11 U.S.C. § 363(c)(1). *See, In re Dant & Russell, Inc.*, 853 F.2d 700 (9th Cir. 1988); *In re Vernon Sand & Gravel, Inc.*, 109 B.R. 255 (Bankr. N.D. Ohio 1989); *In re Pacific Forest Industries, Inc.*, 95 B.R. 740 (Bankr. C.D. Col. 1989).

B. Non-Ordinary Course of Business. If a transaction is not in the ordinary course of business, the trustee must provide notice to all parties in interest and have a hearing before using, selling or leasing property of the estate. 11 U.S.C. § 363(b). *In re Roth American, Inc.*, 975 F.2d 924 (3rd. Cir. 1992). Further, in certain circumstances involving the transfer of "personally identifiable information", additional requirements may need to be met, such as the appointment of a consumer privacy ombudsman. *See* 11 U.S.C. § 363 (b)(1)(A) and (B).

C. Sale Free and Clear. As a general matter, after notice and a hearing, a trustee may sell property of the estate free and clear of all interests of other entities in properties, including liens (11 U.S.C.

§ 363(f)), rights of dower or curtesy (11 U.S.C. § 363(g)), rights of tenants in the entirety (11 U.S.C. § 363(h)), and community property interests (11 U.S.C. § 363(i)). If property is sold free and clear of all interests, the interests of other parties attach to the proceeds from the sale. *See, In re Gerwer*, 898 F.2d 730 (9th Cir. 1990); *In re Akard Street Fuels, L.P.*, 2002 WL 1568332 at *3 (N.D. Tex. 2001).

D. Bankruptcy Auction Sale. A technique debtor's counsel may use is to obtain a court order requiring an auction sale of the real property estate of the debtor. The debtor may seek to require bidders to use a form of purchase and sale agreement that is one-sided in favor of the seller. While this may make some sense in the context of true third party bidders, the mortgagee creditor holding a perfected lien position of record with respect to the real property will have numerous objections to such an arrangement.

The mortgagee creditor will not want to give up the rights and remedies contained in its loan documents or otherwise provided by law nor will it want to deposit earnest money for the right to bid on the purchase of real estate in which it has a lien interest. Yet, if the court grants an order to hold the auction, the creditor will have to participate to assure that title to its collateral is not conveyed without payment of the secured obligation. In other words, it will have to play a part in the bidding process if the bankruptcy court orders the auction to be held.

In this situation a mortgagee creditor will not want to accept the debtor's form of purchase and sale agreement and will need to assure that the court's order allows the creditor to submit the creditor's preferred form of purchase and sale agreement. Exhibit C, attached to this outline, is an example of a form of purchase and sale agreement that could be used by a secured creditor in connection with a bankruptcy court ordered auction of the debtor's sole asset, which in this case is raw land. While it is not entirely one-sided, it can serve to better protect the creditor's interests.

There are many provisions the creditor will want in such a purchase and sale agreement, but the most important will be a section preserving the liens and security interests of the creditor and its right to foreclosure title to the real estate pursuant to its deed of trust and other loan documents. In other words, the purchase agreement must include the elements of a deed in lieu of foreclosure agreement. Even then, the deed transferring title in connection with the auction sale would leave the transferee's title subject to all encumbrances that are subordinate to the creditor's deed of trust lien.[1] To remedy this, Section 1 (e) of Exhibit C contains the components of the agreement by the debtor and creditor that the sale is an absolute transfer of title and not a disguised mortgage and that the creditors liens are not merged with title to the property. The creditor reserves all of its rights and remedies under its deed of trust notwithstanding the extinguishment of the debt of the debtor in bankruptcy. The creditor also retains the right to conduct a foreclosure under those loan documents or as provided in Section 51.006 of the Texas Property Code.[2]

---

1 *Flag-Redfern Oil Company v. Humble Exploration Company, Inc.*, 744 S.W.2d 6 (Tex. 1988).

2 DEED-OF-TRUST FORECLOSURE AFTER DEED IN LIEU OF FORECLOSURE. (a) This section applies to a holder of a debt under a deed of trust who accepts from the debtor a deed conveying real property subject to the deed of trust in satisfaction of the debt.

(b) The holder of a debt may void a deed conveying real property in satisfaction of the debt before the fourth anniversary of the date the deed is executed and foreclosed under the original deed of trust if:

(1) the debtor fails to disclose to the holder of the debt a lien or other encumbrance on the property before executing the deed conveying the property to the holder of the debt in satisfaction of the debt; and

(2) the holder of the debt has no personal knowledge of the undisclosed lien or encumbrance on the property.

Subsection 51.006(e) is particularly useful in this circumstance since it does not have conditions precedent to its exercise as subsection 51.006(b) has. To further assure the absence of liens and encumbrances other than those acceptable to the creditor as purchaser, Section 5(d) of the Purchase Agreement provides the real estate is sold pursuant to Section 363(f) of the Bankruptcy Code free and clear of all liens and encumbrances other than "Permitted Exceptions", which are those of record prior to the Deed of Trust.

The Purchase Agreement is made subject to the Bankruptcy Code and the jurisdiction and orders of the Bankruptcy Court. See subsections 12 (h), (i) and (m). The purchase and sale of the real estate is assumed to be made on an "as is" basis. In other respects the Purchase Agreement has other provisions designed to protect the interests of a purchaser like delivery of various types of information described in Exhibit D to the Purchase Agreement, inspection rights, and certain minimal representations by the debtor as seller. The form does assume that the creditor, if is so desires, will obtain its own updated title report and survey. Creditor's counsel in other situations may wish to try to increase the obligations of the debtor/seller. Debtor's counsel may wish to decrease the obligations of the debtor. The outcome will depend on the facts and circumstances in each case.

IV. Cash Collateral.

A. General. One of the issues that a bankruptcy court must face relates to the debtor's authority to use cash collateral. Pursuant to 11 U.S.C. § 363(c)(2), the trustee in bankruptcy is prohibited from using, selling or leasing cash collateral unless either: (i) the lienholder consents; or (ii) the court, after notice and a hearing, authorizes the use of cash collateral.

B. Definition of Cash Collateral. Pursuant to 11 U.S.C. § 363(a), "cash collateral" is defined as "cash, negotiable instruments, documents of title, 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 proceeds, products, offspring, *rents*, or profits of property subject to a security interest as provided in section 552(b) of this title, whether existing before or after the commencement of the case." Essentially, cash collateral is cash and cash equivalents in which the debtor and a perfected lienholder both own a property interest. *In the Matter of Village Properties, Ltd.*, 723 F.2d 441, 445 (5th Cir. 1984). Frequently, cash collateral is proceeds from other collateral. *See e.g.*, *In re Laurel Hill Paper Co.*, 393 B.R. 89, 92 (Bankr. M.D.N.C. 2008); *In re Empire For Him, Inc.*, 1 F.3d 1156 (11th Cir. 1993); *United Virginia v. Slabfork Coal Co.*, 784 F.2d 1188 (4th Cir. 1986). The issue of whether a lienholder owns a perfected interest in cash collateral is left to state law. *Butner v. United States*, 440 U.S. 48, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979); *Village Properties*, 723 F.2d at 445; *In re Four Bucks, LLC*, 2009 WL 1857432 at *1 (Bankr. N.D. Tex. 2009). Therefore, whether or not cash is "cash collateral" is an issue is best addressed on the basis of type of collateral.

(c) A third party may conclusively rely upon the affidavit of the holder of a debt stating that the holder has voided the deed as provided in this section.

(d) If the holder elects to void a deed in lieu of foreclosure as provided in this section, the priority of its deed of trust shall not be affected or impaired by the execution of the deed in lieu of foreclosure.

(e) If a holder accepts a deed in lieu of foreclosure, the holder may foreclose its deed of trust as provided in said deed of trust without electing to void the deed. The priority of such deed of trust shall not be affected or impaired by the deed in lieu of foreclosure.

C. Impact of 11 U.S.C. § 552. Pursuant to 11 U.S.C. § 552, a pre-petition lien does not attach to property acquired post-petition unless the property acquired is from the proceeds of pre-petition collateral. "Proceeds" is not limited by the technical definition of the UCC, but covers any property into which property subject to the security interest is converted. *In re Corpus Christi Hotel Partners Ltd.*, 133 B.R. 850, 856 (Bankr. S.D. Tex. 1991) (citing H.R. Rep. No. 95-595, 95th Cong. 1st Sess. 377 (1977)).

1. Inventory Example of General Rule. If a lender has a pre-petition lien on inventory, the lien does not extend to inventory acquired by the debtor post-petition. *See, In re Peeler*, 145 B.R. 973 (Bank. E.D. Ark. 1992).

2. Exception to Inventory Example of General Rule. If Debtor sells inventory for accounts receivable, the accounts receivable are proceeds from the sale of inventory and Tex. Bus. & Comm. Code § 9.306 and 11 U.S.C. § 552(b) continues the lien to accounts receivable. If the accounts receivable are converted to cash, the cash is proceeds of proceeds from the sale of inventory, and is subject to the lien of the secured creditor pursuant to Tex. Bus. & Comm. Code § 9.306 and 11 U.S.C. § 552(b). If the debtor then uses the cash to buy new inventory, the pre-petition lien extends to the newly purchased inventory pursuant to 11 U.S.C. § 552(b) and Tex. Bus. & Comm. Code § 9.306. *In re Bumper Sales, Inc.*, 907 F.2d 1430 (4th Cir. 1990); *Matter of Sherwood Ford, Inc.*, 1992 WL 295951 at *3 (D. Md. 1992).

D. Specific Forms of Collateral. Addressing cash collateral is best addressed by examining cash as a proceed from a specific form of collateral.

1. Rent. The different states have two different theories for rents: (1) lien theory of mortgages and (2) the title theory of mortgages. *Village Properties*, 723 F.2d at 443; *In re Spears*, 352 B.R. 83, 89 (Bankr. N.D. Tex. 2006). Under the lien theory, the mortgagee is not the owner of the real estate and is not entitled to possession of the rents. *Village Properties*, 723 F.2d at 443; *Spears*, 352 B.R. at 89. Under the title theory, on the other hand, title to the property and the rents passes from the mortgagor to the mortgagee. *Village Properties*, 723 F.2d at 443; *Spears*, 352 B.R. at 89. In Texas, the courts have adopted the lien theory and an assignment of rents is generally a collateral assignment rather than an absolute assignment. *Taylor v. Brennan*, 621 S.W.2d 592, 594 (Tex. 1981); *In re Spears*, 352 B.R. at 89. The *Taylor* court, however, acknowledged the possible existence of an absolute assignment of rents. As a consequence, since *Taylor*, lenders have restructured the assignment of rents clauses in an effort to create an "absolute assignment" of rents rather than a collateral assignment. *See Fed'l Deposit Ins. Corp.*, 929 F.2d 1033, 1035 (5th Cir. 1991) (citing to *Taylor*, the court stated that the "parties may agree to an assignment of rent that 'operates to transfer the right to rentals automatically upon the happening of a specified condition, such as a default'"). While the Texas Supreme Court acknowledged the existence of an absolute assignment of rents, very few such assignments are reported in the cases. *See, In re Fry Road Assoc., Ltd.*, 64 B.R. 808 (Bankr. W.D. Tex. 1986). In a subsequent case, however, Judge Ayers limited his holding in *Fry Road* to the unique facts of the case, including the fact that pre-petition the lender was collecting rent. *In re Tripplet*, 84 B.R. 84 (Bankr. W.D. Tex. 1988).

a. Perfection of Liens Outside of Bankruptcy.

(1) Absolute Assignment of Rents. If the assignment of rents is an absolute assignment, the document does not create a security interest in rents, but transfers title in the rents to the lender. *Taylor v. Brennan*, 621 S.W.2d at 594; *In re Spears*, 352 B.R. at 89. Thus, upon the happening of a specific event, such as default under the terms of the deed of trust, the right to collect the rents automatically transfers to the lender. *Taylor v. Brennan*, 621 S.W.2d at 594; *In re Spears*, 352 B.R. at 89.

(2) Collateral Assignment of Rents. If the assignment of rents is a collateral assignment, the document only creates a security interest in the rents. *Taylor v. Brennan*, 621 S.W.2d at 594; *In re Spears*, 352 B.R. at 89. Thus, the assignment of rents does not become operative until the lender obtains possession of the property, or impounds the rents, or secures the appointment of a receiver or takes some similar action. *Taylor v. Brennan*, 621 S.W.2d at 594; *In re Spears*, 352 B.R. at 89. Subsequently, at least one bankruptcy case held that merely sending a notice of default and termination of license to collect rents was sufficient action to perfect the lenders interest in rents. *In re Tripplett*, 84 B.R. 84, 89 (Bankr. W.D. Tex. 1988).

b. Historical Perfection in Bankruptcy. In *Village Properties*, the Fifth Circuit acknowledged that the automatic stay and other provisions of the Bankruptcy Code prevented lenders from taking the actions required by the *Taylor* court to perfect an interest in rents. *Village Properties*, 723 F.2d at 446. The *Village Properties* court grasped the language of *Taylor* that the assignment of rents becomes operative when the lender obtains possession of the property, or impounds the rents, or secures the appointment of a receiver or takes some other similar action. *Village Properties*, 723 F.2d at 446. Thus, the *Village Properties* court held that the lender's interest in rents was perfected on the day the lender filed a motion for relief from the automatic stay, because the filing of the motion was the taking of "some other similar action." *Village Properties*, 723 F.2d at 447. *See also, In re Casbeer*, 793 F.2d 1436, 1443 (5th Cir. 1986). Subsequent cases acknowledge that filing a "Notice of Perfection of Interest in Rents" with the court was sufficient action to perfect a lien on rents. *See e.g., In re Lake Austin Centre Joint Venture*, 106 B.R. 106 (Bankr. W.D. Tex. 1989). *In re Salmanson*, 132 B.R. 547, 551 (Bankr. W.D. Tex. 1991). The effect of these cases was a race by the secured lender to file something with the court (i.e. motion for relief, objection to use of rents, notice of perfection, etc.) as soon as possible after the case is filed.

c. 1994 Amendments. In 1994, Congress amended 11 U.S.C. § 552 to have perfection deemed to occur on the petition date. Therefore, the debtor is prohibited from using post-petition rents without consent from the secured lender or an order from the court.

d. Issues to Consider for Collateral vs. Absolute Assignment of Rents. Under Texas law, a mortgagee under a deed of trust with power of sale holds only a lien in the real estate that is the subject of the instrument. *Taylor v. Brennan*, 621 S.W.2d 592, 593 (Tex.

1981). The mortgagee is not entitled to possession of the rents from the real estate prior to foreclosure. To assure they have an interest in rents, mortgagees typically obtain an assignment of the rents as additional security for payment of the loan. The common law rule is that an assignment of rentals does not become operative until the mortgagee obtains possession of the property, or impounds the rents, or secures the appointment of a receiver, or takes some other similar action. *Taylor* at 594. Mortgagees were not satisfied with the protection afforded this type of assignment, which is sometimes referred to as a collateral assignment of rents. The dissatisfaction was due, in part, to concerns regarding whether the assignment would be treated as a perfected interest or lien and the inability of the mortgagee to obtain the right to possession of rents without a foreclosure or other significant effort or cost. Mortgagees turned to absolute assignments of rent, which are not security interests but actual transfer of title to the rents. Because of the many ramifications of the transfer of actual title away from the owner of the real estate and to the mortgagee, courts have been reluctant to construe assignments of rent as absolute. *Id.* The *Taylor* court focused on determining the intent of the parties to an assignment of rent in ascertaining whether it was absolute or merely a pledge. *Id.* "When an assignment of rentals is given as 'further' or 'additional' security, there is a strong indication the parties intended a pledge, . . . while an absolute assignment of rentals is not security, but is a *pro tanto* payment of the obligation." *Id.*

For a period of time, mortgagees and their counsel used or attempted to use absolute assignments of rent to remove the rents from ownership of the borrower in its capacity as a debtor in bankruptcy. If the rents were owned by the mortgagee, they could not be part of the debtor's estate nor available for reorganization.

The *Taylor* court did not elaborate on the elements essential to make an assignment of rents absolute, but the U. S. Fifth Circuit did. *FDIC v. International Property Management*, 929 F.2d 1033 (5th Cir. 1991). In the *International Property Management*, the court again focused on the intent of the parties as evidenced by their agreement. *International Property Management* at 1036. An absolute assignment must not, in the opinion of the Fifth Circuit, contain words like "security" or "pledge" and it must not require the mortgagee to take any action after default to secure the rents. *International Property Management* at 1037. After reviewing the language of the assignment of rents at issue in the case, the Fifth Circuit found it was an absolute assignment, but did not address the issue of a *pro tanto* reduction of the obligation. *International Property Management* at 1038.

The potential risks for a mortgagee attendant to an absolute assignment of rents outweigh the potential benefits. The primary risk is a *pro tanto* reduction in the obligation. 801 *Nolana, Inc. v. RTC Mortgage Trust*, 944 S.W.2d 751, 754 (Tex. App.—Corpus Christi, 1997, writ denied); *NCNB Texas National Bank v. Sterling Projects, Inc.*, 789 S.W.2d 358, 360 (Tex. App.—Dallas 1990, dism'd woj); *In re Tripplet*, 84 Bankr. 84, 88 (Bankr. W.D. Tex. 1988). In plain language, this means a potential reduction in the loan amount equal to the value of the rents absolutely assigned. In the case of an income-producing property, the mortgagee could find its principal or interest greatly reduced. In the *Nolana* case, the lender

had an absolute assignment of rents. The court held that this constituted a *pro tanto* reduction of the obligation, that is, the value of the rents offset the outstanding obligation. The case was remanded to determine if the borrower applied the rents as required by the terms of the loan documents, but the case raises a number of red flags. If the assignment reduces the obligation, does it happen at the inception of the loan? If so, the value of the assignment might exceed the principal balance of the loan. If this happens or even if the principal is merely reduced a significant amount, the interest contracted to be paid or actually received on the stated principal may create a usury claim or defense. Tex. Finance Code Section 305.001(a-1) (2007).

Since the enactment of Section 552(b) (2) of the Bankruptcy Code in 1994, federal law seems to confer automatic perfected status on rents of a debtor that accrue and are paid after the commencement of bankruptcy proceedings if the debtor entered into a security agreement, *i. e.* assignment of rents, covering rents that accrue in the future and that agreement is recorded. Moreover, bankruptcy courts have not routinely allowed the use of absolute assignments of rent to remove the rents from the estate of the debtor in bankruptcy. As a result these factors, one of the major bankruptcy rationales for having an absolute assignment of rents has diminished, if not disappeared.

There continue to be unresolved issues in this area of Texas law and a committee of Real Property, Probate and Trust Law Section of the State Bar of Texas is working on an assignment of rents act to be proposed to the Texas Legislature that would provide for, among other things, a statutory method to perfect an interest in rents.

2. Hotel Receipts. The major question addressed by courts is whether hotel receipts were "rents" or "proceeds from accounts."

a. Hotel Receipts are Accounts. A majority of courts have held that hotel receipts are proceeds from accounts receivable and, as a consequence, a lender must perfect a lien in accordance with article 9 of the Uniform Commercial Code. *In re West Chestnut Realty of Haverford, Inc.*, 166 B.R. 53 (Bankr. E.D. Pa. 1993); *aff'd* 173 B.R. 322 (E.D. Pa. 1994) (Pennsylvania law); *See In re Tri-Growth Centre City, Ltd.*, 133 B.R. 524 (Bankr. S.D. Cal. 1991) (California Law); *In re Majestic Motel Assoc.*, 131 B.R. 523 (Bankr. Maine, 1991) (Maine Law); *In re Days Cal. Riverside Ltd.*, 27 F.3d 374 (9th Cir. 1994) (California Law). The only Texas case on the subject, *In re Corpus Christi Hotel Partners, Ltd.*, 133 B.R. 850 (Bankr. S.D. Tex. 1991), has applied Texas law and held that hotel receipts are the proceeds of accounts.

b. Hotel Receipts are Rents. A minority of courts have held that hotel receipts are rents. *See J-H New Orleans v. Financial Security Assurance*, 10 F.3d 1099 (5th Cir. 1993) (Louisiana Law).

c. Perfection of Hotel Receipts Under Texas Law. Since hotel receipts in Texas are proceeds from accounts, *See, Corpus Christi Hotel Partners*, the debtor should execute a security agreement granting the lender a security interest in accounts receivable and hotel

receipts. Further, the lender should file a UCC-1 with the Secretary of State identifying a security interest in accounts receivable and hotel receipts. I would observe, however, that the Texas Supreme Court has not ruled on the nature of the property interest in accounts receivable and as such, I would recommend filing an assignment of hotel receipts with the real property records.

d. Historical Perfection in Bankruptcy in Texas. Because hotel receipts were proceeds of accounts, and 11 U.S.C. § 552 cut off a lender's security interest in accounts as of the petition date, all post-petition hotel receipts were unencumbered cash to be used by the debtor as it saw fit. *See In re Corpus Christi Hotel Partners Ltd.*, 133 B.R. 850 (Bankr. S.D. Tex. 1991).

e. 1994 Amendments. As a result of the amendments to 11 U.S.C. § 552, a lien on hotel receipts which was perfected pre-petition is perfected post-petition and debtor may not use the receipts without the permission of the secured lender or an order of the court. However, in order to have the benefit of new Section 552, a lender with a lien on hotel receipts must be properly perfected under state law, because new Section 552 was not intended to eliminate the state law distinctions between rents and hotel receipts. *In re Brandywine River Hotel, Inc.*, 177 B.R. 10 (Bankr. E.D. Pa. 1995).

3. Other Forms of Collateral.

a. Golf Course Receipts. Golf course receipts are accounts to be perfected under the Uniform Commercial Code. *In re Everett Home Town Ltd. Partnership*, 146 B.R. 453 (Bankr. Ariz. 1992).

b. Golf Cart Receipts. Golf cart receipts are accounts to be perfected under the Uniform Commercial Code.

E. Application of Rents. The courts have split as to whether rents, which are cash collateral, are additional security over and above the value of the real estate which can be, effectively, applied to the unsecured claim. One line of cases holds that post-petition rents not reinvested into the real estate must be applied to the secured claim. *See Confederation Life Insurance Co. v. Beau Rivage Ltd.*, 126 B.R. 632 (N.D. Ga. 1991); *In re Kalian*, 169 B.R. 503 (Bankr. D.R.I. 1994); *In re IPC Atlanta L.P.*, 142 B.R. 547 (Bankr. N.D. Ga. 1992); *In re Reddington/Sunanow L.P.*, 119 B.R. 809 (Bankr. D.N.M. 1990). A second line of cases holds post petition rents not reinvested into the real estate increases the size of the secured claim thereby effectively reducing the unsecured claim. *In re Union Meeting Partners*, 178 B.R. 164 (Bankr. E.D. Pa. 1995); *In the Columbia Office*, 175 B.R. 199 (Bankr. D. Md. 1994); *In re Bloomingdale Partners*, 155 B.R. 961 (Bankr. N.D. Ill. 1993); *In re Vermont Investment LP*, 142 B.R. 571 (Bankr. D.D.C. 1992); *In re Landing Associates, Ltd.*, 122 B.R. 288 (Bankr. W.D. Tex. 1990); and *In re Flagler-at-First Assoc.*, 114 B.R. 297 (Bankr. S.D. Fla. 1990).

V. Post-Petition Financing.

A. Generally. In cases in which the debtor is an operating entity, one of the initial concerns addressed by the debtor is locating sufficient cash to operate the business. As was discussed *supra*, cash collateral is one source of funds for operation. Another source of operating funds is post-petition financing.

B. Unsecured Debt Incurred in the Ordinary Course of Business. As a general matter, if the trustee is authorized to operate the Debtor's business, unless the court orders otherwise, the trustee or debtor in possession may obtain unsecured credit and incur unsecured debt in the ordinary course of business allowable as an administrative expense under 11 U.S.C. § 503(b)(1). 11 U.S.C. § 364(a). *In re Poff Const., Inc.*, 141 B.R. 104 (W.D. Va. 1992). Examples of ordinary course of business credit include trade credit, wages, short term revolving lines of credit, etc. *In re Poff Const., Inc.*, 141 B.R. at 106. No hearing or court order is required for ordinary course of business credit. *See, In re Massetti*, 95 B.R. 360 (Bankr. E.D. Pa. 1989).

C. Unsecured Debt Not Incurred in the Ordinary Course of Business. The court has the power pursuant to 11 U.S.C. § 364(b) to authorize the trustee to obtain unsecured credit or to incur unsecured debt outside the ordinary course of business of the debtor allowable as an administrative expense under 11 U.S.C. § 503(b)(1). *In re Sherwood Square Associates*, 107 B.R. 872 (Bankr. D. Md. 1989). Prior to authorizing the trustee or debtor in possession to obtain unsecured credit or to incur unsecured debt outside the ordinary course of business of the debtor, the trustee or debtor in possession must serve notice on parties in interest and the court must conduct a hearing. *In re Regensteiner Co.*, 122 B.R. 323 (N.D. Ill. 1990); *Suntrust Bank v. Den-Mark Const., Inc.*, 2009 WL 1528761 at *3 (Bankr. E.D.N.C. 2009).

D. Post-Petition Credit with Super Priority Administrative Claim and/or Non-Priming Liens. Pursuant to 11 U.S.C. § 364(c), the bankruptcy court can authorize the trustee or debtor in possession to obtain credit or incur debts: (1) with priority over all administrative claims (2) secured by a lien on property of the estate not otherwise subject to a lien, or (3) secured by a junior lien on property of the estate that is subject to a lien. *In re Babcock and Wilcox Co.*, 250 F.3d 955, 957 (5th Cir. 2001); *In re Ames Department Stores, Inc.*, 115 B.R. 34 (Bankr. S.D. N.Y. 1990); *In re Aqua Associates*, 123 B.R. 192 (Bankr. E.D. Pa. 1991). To succeed in motion under 11 U.S.C. § 364(c), the debtor must show several factors:

1. The Debtor is unable to obtain unsecured credit as an allowed administrative claim in accordance with 11 U.S.C. § 364(b); *In re Temple Stephens Co., Inc.*, 145 B.R. 975 (Bankr. W.D. Mo. 1992); *In re Aqua Associates*, 123 B.R. at 195-196; *In re Executive Air Services*, 62 B.R. 474 (D. Utah 1986); *In re Ames Department Stores*, 115 B.R. 34, 37 (Bankr. S.D. N.Y. 1990); *In re St. Mary Hospital*, 86 B.R. 393 (Bankr. E.D. Pa. 1988); *Suntrust Bank*, 2009 WL 1528761 at *4-5.

2. The credit transaction is necessary to preserve assets of the estate; *In re Aqua Associates*, 123 B.R. at 196, *In re Ames Department Stores*, 115 B.R. at 39.

3. The terms of the transaction are fair, reasonable, and adequate, given the circumstances of the debtor-borrower and the proposed lender. *In Re Aqua Associates*, 123 B.R. t 196, *In re Ames Department Stores*, 115 B.R. at 38, *In re Tenney Village Co.*, 104 B.R. 562 (Bankr. D. N.H. 1989).

E. Priming Liens. Pursuant to 11 U.S.C. § 364(d), the court has the power to authorize a debtor-in-possession or a trustee to obtain credit or incur debt secured by a senior or equal lien on property of the estate that is subject to a lien only if: (1) the trustee or debtor in possession is not otherwise able to obtain credit and (2) the interest of the holder of the pre-existing lien is adequately protected. 11 U.S.C. § 364(d)(1)(A) and (B);

1. Requirements of 11 U.S.C. § 364(c). The courts that have written on 11 U.S.C. § 364(d) require the trustee or debtor in possession to establish the requirements to obtain credit under 11 U.S.C. § 364(c) discussed *supra*. *See, In re Aqua Associates*, 123 B.R. at 195-196; *In re Ames Department Stores*, 115 B.R. at 37-40.

2. Adequate Protection. The principal issue addressed by the courts is whether the existing lienholders interest is adequately protected. In determining whether a creditors interest is adequately protected, the *Aqua Associates* court stated that the "important question . . . is whether that [secured creditor's] interest, whatever it is, is not being unjustifiably jeopardized." *Aqua Associates*, 123 B.R. at 196 (citing *In re Grant Broadcasting of Philadelphia, Inc.*, 71 B.R. 376, 386-89 (Bankr. E.D. Pa.) *aff'd*, 75 B.R. 819 (E.D. Pa. 1987) and *In re Alyucan Industries, Inc.*, 12 B.R. 803, 809-12 (Bankr. D. Utah 1981)); *see also Sun Trust Bank*, 2009 WL 1528761 at *7 (the purpose of the adequate protection requirement is to ensure that the secured creditor receives in value essentially what he bargained for).

a. Holistic Approach. The *Aqua Associates* court adopted a "holistic approach" to adequate protection, which is measured by "an analysis of all of the relevant facts, with a particular focus upon the value of the collateral, the likelihood that it will depreciate or appreciate over time, the prospects of a successful reorganization of the debtor's affairs by means of the plan, and the debtor's performance in accordance with the plan." *Aqua Associates*, 123 B.R. at 196-97.

b. Equity Cushion. Many courts look to the existence of an equity cushion as a means of adequate protection. *Aqua Associates*, 123 B.R. at 196, *In re Snowshoe Co.*, 789 F.2d 1085 (4th Cir. 1986), *Anchor Savings Bank FSB v. Sky Valley*, 99 B.R. 117 (N.D. Ga. 1989), *In re Danes Casino, Hotel*, 69 B.R. 784 (Bankr. D. N.J. 1986); *In re Phoenix Steel Corp.*, 39 B.R. 218 (D. Del. 1984); *In re Tenney Village Co.*, 104 B.R. 562 (Bankr. D. N.H. 1989); *In re Reading Tale Industries, Inc.*, 72 B.R. 329 (Bankr. E.D. Pa. 1987); *In re D.B.G. Ltd*, 150 B.R. 570 (Bankr. N.D. Pa. 1992); *In re Beach*, 169 B.R. 201 (D. Kan. 1994). Generally, if no equity cushion exists, the pre-existing lienholder will not be adequately protected. *In re Beach*, 169 B.R. 201 (D. Kan. 1994).

c. Substitute Collateral. Another form of adequate protection is to grant the pre-existing lienholder a new lien on substitute collateral. *In re Swedeland Development Group, Inc.*, 16 F.3d 552 (3rd Cir. 1994).

d. Third Party Guaranty. Yet another form of adequate protection may be a third party guaranty. *In re Swedeland Development Group, Inc.*, 16 F.3d at 561.

3. Cross Collateralization. In many post-petition financings, the pre-petition secured lender is the same as the post-petition lender. Many lenders try to cross-collateralize the pre-petition debt with the post-petition collateral. Such cross-collateralization is generally forbidden. *See, In the Matter of Saybrook Mfg. Co., Inc.*, 963 F.2d 1490 (1992); *In re Corley Capital Group*, 128 B.R. 652 (Bankr. W.D. Wis. 1991).

F. Reversal or Modification. If an order authorizing the debtor in possession or trustee to obtain credit or incur debt is reversed or modified on appeal, the reversal or modification does not affect the validity of any debt incurred or the priority or lien granted in the order, so long as the credit was extended in good faith. 11 U.S.C. § 364(e).

VI. Landlord/Tenant Issues.

A. General. In certain bankruptcy cases, some of the most significant assets or liabilities of a debtor are executory contracts and/or unexpired leases. To address the issues of both executory contracts and unexpired leases, Congress enacted 11 U.S.C. § 365. In this article, the emphasis of 11 U.S.C. § 365 will be on unexpired leases, however, some of the issues apply both to unexpired leases and executory contracts.

B. Definition of Executory Contract. One of the principal issues addressed by the courts is whether a contract is an "executory contract." While 11 U.S.C. § 365 provides a mechanism for resolving issues relating to executory contracts, the Bankruptcy Code does not provide a definition of "executory contract." The most widely accepted definition of an executory contract was proposed by Professor Vern Countryman in his article "Executory Contracts in Bankruptcy," 57 *Minn. L. Rev.* 439 (1973). Countryman proposed that an executory contract be defined as "a contract under which both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." *Id*. at 460. Most courts have explicitly adopted Countryman's definition of executory contract. *See Giddings Petroleum Corp. v. Peterson Food Mart, Inc.*, 859 S.W.2d 89, 92 (Tex. App.--Austin 1993); *Gowveia v. Tazbir*, 37 F.3d 295, 298 (7th Cir. 1994); *In re Knutson*, 563 F.2d 916, 917 (8th Cir. 1977). However, the analysis of whether any given contract is executory varies upon the facts of each case.

1. Examples of Executory Contracts.

a. Management Agreement.

b. Option Agreement. *In re Plum Run Service Corp.*, 159 B.R.496 (Bankr. S.D. Ohio 1993); *In re Carlisle Homes, Inc.*, 103 B.R. 524 (Bankr. D.N.J. 1988).

c. Employment Agreement. *In re Constant Care Community Health Center, Inc.*, 99 B.R. 697 (Bankr. D. Md. 1989.

d. Contract for Deed. *In re Speck*, 798 F.2d 279 (8th Cir. 1986); *In re Terrell*, 892 F.2d 469 (6th Cir. 1989); *In re Frontier Properties, Inc.*, 979 F.2d 1358 (9th Cir. 1992);

In re Finley, 138 B.R. 181 (Bankr. E.D. Tex. 1992); *In re Hendrickson*, 2005 WL 3670876 at *2 (Bankr. N.D. Tex. 2005).

e. Personal Service Contract. *In re Taylor*, 913 F.2d 102 (3rd Cir. 1992); *In re Vedia*, 150 B.R. 393, 400 (Bankr. S.D. Tex. 1992).

2. Examples of Contracts that are not Executory.

a. Reciprocal Deed Restrictions. *Gowveia v. Tazbi*, 37 F.3d 295 (7th Cir. 1994).

b. Executory Interests in Land such as a Possibility of Reverter. *See*, Hesse, "Impact of Bankruptcy on Deed Restrictions and Executory Interests, *American Bankruptcy Institute Journal*, Vol XIV., No. 2 (March, 1995).

c. Insurance Contracts. *In re Texscan Corp.*, 976 F.2d 1269 (9th Cir. 1992). *But see In re Transit Group, Inc.*, 2002 WL 31940797 at *4 (Bankr. M.D. Fla. 2002) (insurance policy is executory if insured had a continuing obligation to make premium payments under the policy); *In re Sudbury, Inc.*, 153 B.R. 776 (Bankr. N.D. Ohio 1993) (same).

d. Promissory Note. *In re EES Lambert Assoc.*, 62 B.R. 328 (Bankr. N.D. Ill. 1986).

C. Assumption or Rejection. Once a bankruptcy is filed, the debtor has the right to assume or reject all executory contracts and unexpired leases. 11 U.S.C. § 365(a).

1. Procedure. To assume, reject or assign an executory contract or unexpired lease, the trustee or debtor-in-possession must file a motion with the court, and provide notice of the motion and the hearing to the parties in interest. Fed. R. Bankr. P. 6006. After a hearing, the court will either approve or disapprove the request to assume or reject an executory contract or unexpired lease. 11 U.S.C. § 365(a); *In re Mirant Corp.*, 197 Fed. Appx. 285, 288 (5th Cir. 2006).

2. Effect of Rejection. If an executory contract or unexpired lease is rejected, it is deemed breached on the day before the petition date. 11 U.S.C. §§ 365(g) and 502(g). The claim arising from a rejected executory contract or unexpired lease is a general unsecured claim. 11 U.S.C. § 502(g). The amount of the claim arising from an unexpired lease or executory contract is determined in accordance with the relative substantive law associated with the rejected contract.

3. Effect of Assumption.

a. Cure. Before the court will approve assumption of an executory contract or unexpired lease, the trustee or debtor-in-possession must cure or make adequate assurances that it will cure all defaults. 11 U.S.C. § 365(b)(1)(A). *Moody v. Amoco Oil Co.*, 734 F.2d 1200 (5th Cir. 1984); *In re PRK Enterprises, Inc.*, 235 B.R. 597 (Bankr. E.D. Tex. 1999);

In re Wilson, 69 B.R. 960 (Bankr. N.D. Tex. 1987); *In re Prime Motor Inns*, 166 B.R. 993 (Bankr. S.D. Fla. 1994). Notwithstanding the language of 11 U.S.C. § 365(b)(1), the trustee or debtor-in-possession does not have to cure defaults relating to (i) the insolvency or financial condition of the debtor; (ii) the commencement of a bankruptcy case; (iii) the appointment of a trustee, receiver or custodian, or (iv) penalties resulting from non-monetary defaults. 11 U.S.C. § 365(b)(2).

b. Compensate. Before the court will approve assumption of an unexpired lease or executory contract, the trustee or debtor-in-possession must compensate or provide adequate assurance that it will promptly compensate a party (other than the debtor) to such contract or lease for any actual pecuniary loss caused by the default. 11 U.S.C. § 365(b)(1)(B).

c. Future Performance. Before the court will approve assumption of an executory contract or unexpired lease, the trustee or debtor-in-possession must provide adequate assurance of future performance. 11 U.S.C. § 365(b)(1)(C); *Richmond Leasing Co. v. Capital Bank, N.A.*, 762 F.2d 1303 (5th Cir. 1985); *In re Texas Health Enterprises, Inc.*, 72 Fed. Appx. 122, 126 (5th Cir. 2003).

4. Limitations on Assumption. Not all executory contracts can be assumed.

a. Non-Assignable Contracts. If state or federal substantive law excuses a party from accepting performance from or rendering performance to one other than the debtor and such party does not consent, then the contract cannot be assumed. 11 U.S.C. § 365(c)(1). Examples include personal service contracts. *Leonard v. General Motors Corp.*, 13 F.3d 674 (3rd Cir. 1993), nonexclusive patent licenses, *Perlman v. Catapult Entertainment, Inc. (In re Catapult Entertainment, Inc.*), 165 F.2d F.3d 747 (9th Cir. 1999), partnership agreements, *In re O'Conner*, 258 F.3d 392 (5th Cir. 2001); *but see In re Lil' Things*, 220 B.R. 583 (Bankr. N.D. Tex. 1998) (general prohibition on assignments of leases without landlord consent under Texas Property Code Section 91.005 is not covered by 365(c)(1)(A)).

b. Financial Contracts. The trustee or debtor-in-possession cannot assume an agreement to make a loan, extend credit or financial accommodations to or for the benefit of the debtor, or to issue a security of the debtor. 11 U.S.C. § 365(c)(2). *In re III Enterprises, Inc. V.*, 163 B.R. 453 (Bankr. E.D. Pa. 1994).

5. Landlord Bankruptcies. In its bankruptcy, a landlord has the right to assume or reject the leases of its tenants. 11 U.S.C. § 365(a).

a. Assumption. If the debtor landlord assumes the tenant leases, the landlord must perform all its obligations under the lease.

b. Rejection. If the debtor landlord rejects the tenant lease, the tenant has two options: (i) the tenant can treat the lease as terminated *see, In the Matter of Austin*

Development Co., 19 F.3d 1078, 1082 (5th Cir. 1994), or (ii) the tenant can retain its rights under the lease, including the rights to retain possession of leasehold estate, the amount of rent and the timing of payment of rents. 11 U.S.C. § 365(h)(1)(A). *In re Chestnut Ridge Plaza Assoc., L.P.*, 156 B.R. 477 (Bankr. W.D. Pa. 1993). As far as possession is concerned, if a debtor landlord rejects a lease, possession of the premises may be retained by the tenant indirectly through a subtenant. *In re Stanley Station Assoc., L.P.*, 179 B.R. 82, 686 (Bankr. D. Kan. 1995). If a tenant chooses to remain in the premises, the rejection of the lease by the debtor-landlord does not alter the substantive right of the parties to the lease and does not alter the terms effecting the amount of rent owned by the tenant to the debtor-landlord. *Megafoods Stores, Inc. v. Flagstaff Realty Associates (In re Flagstaff Realty Associates)*, 60 F.3d 1031, 1034 (3rd. Cir. 1995); *In re Fleming Cos.*, 2007 WL 788921 at *3 (D. Del. 2007). Thus, if the lease provides for rent increases after the lease is rejected, the tenant is liable to the debtor-landlord for the increased rent. *In re Branchaud*, 186 B.R. 337 (Bankr. D.R.I. 1995). The effect of rejection of a lease by a debtor-landlord is to relieve the estate of the burden of providing continuing services to the tenant such as utilities, repairs, maintenance services, and janitorial services. *Flagstaff Realty Associates*, 60 F.3d at 1034.

6. Tenant Bankruptcies. In its bankruptcy, a tenant debtor has the right to assume or reject its lease. However, 11 U.S.C. § 365 provides different duties for commercial and residential leases.

a. Commercial Leases.

(1) Time of decision. The trustee or debtor in possession only has 120 days (or less) to make a decision as to whether it will assume or reject the lease. 11 U.S.C. § 365(d)(4). Specifically, the lease shall be deemed rejected if the trustee or debtor in possession does not assume or reject the lease by the earlier of: (i) 120 days after the petition date; or (ii) the date the order confirming a plan in entered. 11 U.S.C. § 364(d)(4)(A) and (B). However, if the 120-day deadline is insufficient, the trustee or debtor in possession may obtain a 90-day extension from the court, prior to the expiration of the 120-day deadline. 11 U.S.C. § 365(d)(4).

(2) Tenant's Duties Pending Decision. Prior to assuming or rejecting a lease, the trustee or debtor in possession must perform all obligations arising under the lease. 11 U.S.C. § 365(d)(3).

(3) Assumption. If a tenant debtor assumes a lease, it has the obligation to perform all its obligations under the lease. 11 U.S.C. § 365(d)(3).

(4) Rejection. If a tenant debtor rejects a lease, the tenant has certain duties and the landlord has certain rights.

(a) Possession. The landlord is entitled to immediate possession of the rejected lease. 11 U.S.C. § 365(d)(4).

(b) Impact of Rejection on Creditors Rights. If tenant-debtor has previously assigned the leasehold interest as security to a creditor, the tenant-debtor rejection of the lease does not terminate the creditor's rights in the lease because the creditor's interest was not part of the bankruptcy estate and 11 U.S.C. § 365(d) should not be interpreted in a manner that forfeits the rights of third parties in the lease. *In the Matter of Austin Development Co.*, 19 F.3d 1078 (5th Cir. 1994); *In re H.B. Leasing Co.*, 188 B.R. 810 (E.D. Tex. 1995). It is my opinion that this decision is wrong. The rights of a creditor of a tenant-debtor are derived from those of the tenant-debtor. If the tenant-debtor loses all rights in a lease, his creditors cannot retain their rights.

(c) Effective Date of Rejection. The Courts have split as to whether the effective date of rejection is the day the court approves rejection, *See e.g., In re Revco D.S., Inc.*, 109 B.R. 264 (Bank. N.D. Ohio 1989), *In re 1 Potato 2, Inc.*, 182 B.R. 540 (Bankr. D. Minn. May 31, 1995); *In re Cafeteria Operators L.P.*, 299 B.R. 384, 394 (Bankr. N.D. Tex. 2003), or the day the trustee files the motion to reject the lease, *see, e.g., In re Joseph C. Spiess*, 145 BR 597 (Bankr. N.D. Ill. 1992); *In re Thinking Machines, Corp.*, 67 F.3d 1021 (1st Cir. 1995). For a more thorough discussion of the issue, please see Hesse, "A Return to Confusion and Uncertainty is the Effective Date of Rejection of Commercial Leases in Bankruptcy: A Critical Analysis of *Revco* and *Joseph C. Spiess Co.*," 9 *Bankr. Dev. J.* 521 (1993).

(d) Claim Amount. Upon rejection, the landlord has two claims against the Debtor tenant.

i) Administrative Claim. In the event the debtor in possession or the trustee has failed to timely pay rent in accordance with 11 U.S.C. § 365(d)(3), the landlord has an administrative claim pursuant to 11 U.S.C. § 503 for all rent and other similar charges through the effective date of rejection. *See e.g., In re Joseph C. Spiess Co.*, 145 B.R. 597, 607 (Bankr N.D. Ill. 1992). The courts, however, disagree as to whether unpaid post-petition rent is an administrative claim, *see, e.g., Spiess*, 145 B.R. at 608 or a "super-priority" administrative claim, which has priority over other administrative expenses. *See e.g., In re Telesphere Communications, Inc.*, 148 B.R. 525 (Bankr. N.D. Ill. 1992); *In re CQ, LLC*, 343 B.R. 915, 916 (Bankr. W. D. Wisc. 2005). For a more thorough discussion of the issue of priority, please see Hesse, "Post-petition Obligations of Commercial Leases in Bankruptcy: Priority or *De Facto* Superpriority Administrative Claims," 3 J.Bankr. L. & Prac. 189 (1994).

ii) Unsecured Claim. The remaining damages from the debtor's breach (i.e. rejection) of the lease is a general unsecured claim. 11 U.S.C. § 502(b)(6).

iii) Limitation of Claim. A claim based on the rejection of a real property lease may not exceed the greater of one year of rent or 15 percent, not to exceed three years, of the remaining term of the lease. 11 U.S.C. § 502(b)(6).

b. Residential Leases.

(1) Chapter 7. In a case under Chapter 7, the trustee has 60 days to assume or reject the lease. If the lease is not assumed, it is deemed rejected at the end of the 60 day period. 11 U.S.C. § 365(d)(1).

(2) Reorganization Cases. In a case under Chapter 9, 11, 12 or 13, the trustee or debtor has until confirmation of a plan to assume or reject a residential lease. 11 U.S.C. § 365(d)(2).

(3) Observation About Performance. Unlike commercial leases, the Bankruptcy Code does not require the debtor in possession or trustee to perform the obligations of a residential lease pending the decision to assume or reject.

VII. Treatment in Successful Chapter 11.

Chapter 11 is the reorganization chapter for corporations, partnerships and certain individuals. The scope of this section will be limited to the plan process and the effect of confirming a plan of reorganization, especially the treatment that creditors may expect to receive under a plan.

A. Disclosure Statement. Prior to disseminated a plan of reorganization to creditors and parties in interest, the court must approve a disclosure statement prepared by the plan proponent. 11 U.S.C. § 1125(b). To approve the disclosure statement the court must conclude that the disclosure statement contains "adequate information" that would enable a hypothetical reasonable investor to make an informed decision about the plan. 11 US.C. § 1125. *In re Cajun Elec. Power Co-op., Inc.*, 150 F.3d 503 (5th Cir. 1998); *In re Rook Broadcasting*, 154 B.R. 970 (Bankr. D. Idaho 1993). "Adequate information" varies from debtor to debtor.

B. The Plan.

1. Exclusive Period. Pursuant to 11 U.S.C. § 1121, the debtor has the exclusive right to file a plan for 120 days after the petition date. If the debtor files a plan within the 120 day exclusive period, it obtains the exclusive right to confirm a plan within 180 days after the petition date. The debtor may obtain from the court an extension to the exclusive period. If the debtor fails to file and confirm a plan within the exclusive period, or if a Chapter 11 trustee is appointed, then any party in interest may file and confirm a plan.

2. Classification. In the plan, the plan proponent may classify substantially similar claims or interests in a particular class. 11 U.S.C. § 1122. A question exists as to whether substantially similar claims can be separately classified in an effort to gerrymander a class of claims that will vote in favor of the plan. *See In re Greystone III Joint Venture*, 995 F.2d 1274 (5th Cir. 1991); *In re Boston Post Road, L.P.*, 21 F.3d 477 (2nd Cir. 1994).

3. Voting. The holders of allowed claims and interests are allowed to vote to reject or accept a plan. 11 U.S.C. § 1126(a). A claim that is the subject of an objection to its allowance is not an allowed claim and the holder of that claim may not vote on the plan. A class of claims has voted to accept a plan if two-thirds in amount and more than one-half in number of the allowed claims in the class vote to accept the plan. 11 U.S.C. § 1126(c). *In re Bloomingdale Apt. Assoc.*, 155 B.R. 961 (Bankr. N.D. Ill. 1993); *In re Eitenmiller*, 149 B.R. 626 (Bankr. D. Idaho 1993). A vote will not count if the vote was not made in good faith or the vote was not solicited in good faith. 11 U.S.C. § 1126(e). *See In re Combustion Engineering, Inc.*, 391 F.3d 190 (3d Cir. 2004).

4. Treatment of Claims and Interests.

a. Consensual Plan. If the debtor proposes a plan acceptable to all classes of creditors, the Bankruptcy Code does not limit the options for treatment of claims and interests in any way. *See* 11 U.S.C. § 1129(a).

b. Non-Consensual Plan. If the debtor proposes a plan that is acceptable to at least one class of impaired creditors, but not all classes of impaired creditors, the court may still confirm the plan over the objections of creditors under the "cram down" provisions of 11 U.S.C. § 1129(b). In effect, the "cram-down" provision is the "worst case scenario" for a creditor. The "cram-down" provision of 11 U.S.C. § 1129(b) requires that the plan not discriminate unfairly and incorporates the "absolute priority rule".

(1) Treatment of Objecting Class of Secured Creditors. To confirm a plan over the objection of a secured creditor, the plan must provide that the secured creditor receive: (a) the net present value of its secured claim while it retains its lien, (b) the proceeds from a sale of the collateral, or (c) the "indubitable equivalent" of its secured claim. 11 U.S.C. § 1129(b)(2)(A). EXAMPLE: If a secured creditor has a secured claim of $500,000, the plan must provide him with property with a value of $500,000 plus a market rate of interest over the life of the plan. *See In re Bryson Properties, XVIII*, 961 F.2d 496 (4th Cir. 1992).

(2) Treatment of Objecting Unsecured Creditors. To confirm a plan over the objection of a class of unsecured creditors, the plan must either (a) pay the unsecured creditor in full, with a market rate of interest, or (b) provide that no claims or interests junior to the class of unsecured creditors receive anything under the plan. 11 U.S.C. § 1129(b)(2)(B). *Id.*; *In re Adelphia Comms. Corp.*, 544 F.3d 420 (2d Cir. 2008); *In re Woodbrook Assocs.*, 19 F.3d 312 (7th Cir. 1994).

(3) Treatment of Objecting Interest Holders. To confirm a plan over the objection of a class of interest holders, the plan must provide that no interest holders junior to the objecting class of interest holders receive anything under the plan. 11 U.S.C. § 1129(b)(2)(C). This is known as the "absolute priority rule"—it generally assures that creditors receive payments over equity interest holders.

(4) New Value Exception. Notwithstanding the absolute priority rule, some courts have held that a plan can provide for junior interest holders to retain their interests even though the plan does not pay senior interest holders in full, if the junior interest holders contribute new capital to the debtor. This "new value exception" to the absolute priority rule has been greatly debated and its existence has been left in doubt by the Supreme Court. *Bank of America Nat'l Trust & Savings Ass'n. v. 203 N. LaSalle St. Partnership*, 526 U.S. 434, 119 S.Ct. 1411 (1999).

c. Treatment of Non-Recourse Secured Claims. If a secured claim is non-recourse, the claim is treated as if it is a recourse claim in the plan of reorganization. 11 U.S.C. § 1111(b). *In re 680 Fifth Ave. Assoc.*, 29 F.3d 95 (2nd Cir. 1994). The exception to the foregoing is if the property securing the claim is sold under the plan or pursuant to 11 U.S.C. § 363, then the secured creditors' recovery is limited by the proceeds of the sale. 11 U.S.C. § 1111(b). *In re SubMicron Systems Corp.*, 432 F.3d 448 (3d Cir. 2006); *In re Tampa Bay Assoc. Ltd.*, 864 F.2d 47 (5th Cir. 1989).

5. Effect of Confirmation.

a. New Contract. Confirmation of a plan of reorganization is the creation of a new contract between the debtor and the creditors. 11 U.S.C. § 1141. All the creditors are bound by the plan.

b. Res judicata. The order of confirmation is res judicata to any subsequent suit to enforce rights modified under the plan. *FOM Puerto Rico S.E. v. Dr. Barnes Eyecenter Inc.*, 255 Fed.Appx. 909, 911 (5th Cir. 2007); *Republic Supply Co. v. Shoaf*, 815 F.2d 1046 (5th Cir. 1987).

c. Discharge. The debtor is discharged from all pre-confirmation liabilities. *In re Nat'l Gypsum Co.*, 208 F.3d 498 (5th Cir. 2000).

d. Property. The property of the estate is revested in the debtor free and clear of all pre-petition liens, claims and encumbrances. 11 U.S.C. § 1141. Thus, if a plan does not provide that a secured creditor's lien survives confirmation, the secured creditor's claim under the plan becomes unsecured. *See In re Ahern Enterprises, Inc.*, 507 F.3d 817 (5th Cir. 2007)*; In re Penrod*, 169 B.R. 910 (Bankr. N.D. Ind. 1994), *aff'd* 50 F.3d 459 (7th Cir. 1995).

C. "Small Business" Bankruptcies. In the 1994 Amendments, Congress provided special rules for "small business" bankruptcies. That intent was to minimize costs and to streamline the process.

1. Definition. "Small business" has been defined in 11 U.S.C. § 101 (51C) as a person engaged in commercial or business activities (but does not include a person whose primary activity is the business of owning or operating real property and activities incidental thereto) whose aggregate noncontingent liquidated secured and unsecured debts as of the date of the petition do not exceed $2,000,000.

2. No Creditors Committee. In a "small business" case, the court may order that no creditors committee be formed. 11 U.S.C. § 1102(a)(3).

3. Exclusive Period. In a "small business" case, the exclusive period for filing a plan is shortened from 120 days to 100 days. 11 U.S.C. § 1121(e).

4. Conditional Approval of Disclosure Statement. In a "small business" case, the court may conditionally approve a disclosure statement subject to final approval after notice and hearing. 11 U.S.C. § 1125(f)(1). The final hearing to approve the disclosure statement may be combined with a hearing on confirmation of plan. 11 U.S.C. § 1125(f)(3).

5. Solicitation of Acceptances or Rejections. The plan and disclosure statement has to be mailed only 10 days prior to the confirmation hearing. 11 U.S.C. § 1125(f)(2).

VIII. Treatment in Successful Chapter 13.

Chapter 13 is the consumer reorganization chapter of the Bankruptcy Code. Once again, this paper will only address treatment in the context of a contested Chapter 13.

A. Eligibility. The debt limitations for Chapter 13 eligibility are a maximum of $250,000 of non-contingent, liquidated unsecured debt and $750,000 of non-contingent, liquidated secured debt. 11 U.S.C. § 109(e).

B. Principal Residence. A Chapter 13 plan cannot modify the rights of a creditor holding a lien on real estate constituting the debtor's principal residence. 11 U.S.C. § 1322(b)(2). *Nobleman v. Am. Savings Bank*, 508 U.S. 324, 124 L. Ed.2d 228, 113 S.Ct. 2106 (1993). However, the Chapter 13 plan can provide for curing a default on the debtor's principal residence through the plan. 11 U.S.C. § 1322(c). In light of the present mortgage crisis, some have advocated amending the Bankruptcy Code to permit a bankruptcy court to "cram down" a lien on an individual's principal residence.

C. Other Secured Claims. A Chapter 13 plan can modify the rights of secured creditors other than a creditor with a claim secured by the debtor's principal residence. 11 U.S.C. § 1322(b)(2). To confirm a plan over the objection of a secured creditor, the Chapter 13 plan must provide either: (i) payments equaling the present value of the secured claims; or (ii) surrender of the property to the secured creditor. 11 U.S.C. § 1325(a)(5). *See also Assocs. Comm. Corp. v. Rash*, 520 U.S. 953, 117 S.Ct. 1879 (1997); *In re Howard*, 972 F.2d 639, 642 (5th Cir. 1992).

D. Unsecured Claims. To confirm a Chapter 13 plan over the objection of an unsecured creditor, the plan must provide payments to the unsecured creditor which exceed the amount the unsecured creditor would receive in a Chapter 7. 11 U.S.C. § 1325(b).

E. Effect of Confirmation.

1. Binds Creditors and Debtors. The terms of a confirmed Chapter 13 plan bind the debtor and all creditors, even those creditors who did not vote for the plan. 11 U.S.C. § 1327(a).

2. Property Vests in Debtor. Upon confirmation, all property of the estate vests in the debtor free and clear of any claim or interest of any creditor provided for in the plan, unless the plan provides for a retention of the lien. 11 U.S.C. § 1327(b). Thus, some courts have held that a security interest in property terminates if the lien is not retained in the plan. *In re Fesq*, 153 F.3d 113 (3d Cir. 1998); *In re Pence*, 905 F.2d 1107 (7th Cir. 1990). On the other hand, the Fifth Circuit has held that a secured creditor is not bound by a plan that purports to reduce its claim or bar enforcement of its lien where no objection to the creditor's proof of claim has been filed. *In re Howard*, 972 F.2d 639 (5th Cir. 1992). Other jurisdictions apply a third approach, holding that if a chapter 13 plan contemplates valuing a secured creditor's collateral and reforming its lien according to that valuation, the secured creditor must be given notice that a valuation hearing is to take place along with the notice of the confirmation hearing. *Piedmont Trust Bank v. Linkous (In re Linkous)*, 990 F.2d 160 (4th Cir. 1993).

F. Discharge. A Chapter 13 debtor does not receive his discharge until he completes all payments under this Chapter 13 plan. 11 U.S.C. § 1325.

IX. Selected Avoidance Issues.

A. General. One of the principal fears of any creditor involved with a financially distressed entity is that the financially distressed entity will file for bankruptcy and seek to recover transfers made prior to the bankruptcy as preferences or fraudulent transfers. This article will generally address some of the issues faced by entities holding interests in real estate, but is not an exhaustive discussion of avoidance issues by any means.

B. Preference. The most feared (or at least distasteful) of the trustee's powers is the power to avoid and recover a payment as a preference. A preference is a "no-fault" cause of action to recover payments made by the debtor to a creditor. Congress' purpose in enacting the preference statute was to further the goals of equality of distribution among creditors of equal priority and deterrence of the race of diligence of creditors to dismember the debtor before the bankruptcy. *Union Bank v. Wolas*, 502 U.S. 151, 1125 Ct. 527, 116 L.Ed.2d 514 (1991).

1. *Prima Facie* Preference. The specific elements of a preference are set out in 11 U.S.C. § 547(b). However, the Supreme Court has succinctly summarized the preference cause of action as the authority of a debtor-in-possession or bankruptcy trustee to

> avoid any transfer of any interest of the debtor in property *if* five conditions are satisfied and *unless* one of seven exceptions defined in subsection (c) is applicable. In brief, the five characteristics of avoidable preference are that it (i) benefit a creditor; (ii) be on account of an antecedent debt; (iii) be made while the debtor was insolvent; (iv) be within 90 days before bankruptcy; and (v) enable the creditor to receive a larger share of the estate than if the transfer had not been made.

Union Bank v. Wolas, 502 U.S. 151, 112 S.Ct. 527, 529-30, 116 L.Ed. 2d 514 (1991) (emphasis in original); 11 U.S.C. § 547(b). If the creditor that receives the transfer or the creditor to whose benefit the transfer is made is an insider, the preference period is extended from 90 days to one year. 11 U.S.C. § 547(b)(4).

2. Potential Defendants. A debtor-in-possession may recover a transfer avoided as a preference from (i) the initial recipient of the transfer; (ii) the entity for whose benefit the transfer was made, or (iii) any immediate or mediate transferee from the initial transferee unless such transferee takes the transfer in good faith and for value. 11 U.S.C. § 550.

3. Common Attacks to *Prima Facie* Preferences. Before turning to the affirmative defenses, a brief discussion of common fact situations that do not rise to the level of preference is in order.

a. Over Secured Creditor. If a creditor is over secured, then any payment received is typically not a preference because such payment will not enable it to receive more from the estate than if it had not received payment. *See In re El Paso Refinery, L P*, 171 F.3d 249 (5th Cir. 1999).

b. Payment from Collateral. If a creditor recovers its collateral (*i.e.*, forecloses) or receives payment from proceeds of its collateral, the payment will not enable the creditor to receive more from the estate than if it had not received the transfers. *Id*.; *Waslo v. MNC Commercial Corp.*, 161 B.R. 107 (Bankr. E.D. Pa. 1993).

c. Prepayment. If an entity receives payments before the goods are delivered or before services are rendered, the payment is not on account of an antecedent debt. *See In re Middendorf*, 381 B.R. 774 (Bankr. D. Kan. 2008).

4. Common Affirmative Defenses. In 11 U.S.C. § 547(c), Congress enacted several affirmative defenses, which were designed to encourage creditors to conduct business with financially distressed entities.

a. Contemporaneous Exchange. The trustee may not avoid a transfer intended by the debtor and creditor to be a contemporaneous exchange for new value given to the debtor, which was in fact substantially contemporaneous. 11 U.S.C. § 547(c)(1). The contemporaneous exchange defense typically applies to the purchase of goods or services in exchange for cash or a check. *See Morrison v. Champion Credit Corp. (In re Barefoot)*, 952

F.2d 795 (4th Cir. 1991); *Roeder v. Climax Molybdenum Co. (In re Old Electalloy Corp.*, 164 B.R. 501 (Bankr. W.D. Pa. 1994). The contemporaneous exchange defense is typically not applicable to credit transactions. *See, e.g., Morrison v. Champion Credit Corp. (In re Barefoot)*, 952 F.2d 795 (4th Cir. 1991). *But see In re Hechinger Inv. Co. of Delaware, Inc.*, 489 F.3d 568 (3d Cir. 2007) ("A court may find the parties intended a contemporaneous exchange for new value even when the transaction is styled as a 'credit' transaction.").

b. Ordinary Course of Business Defense. The trustee may not avoid a transfer that is: (i) in payment of the debt incurred by the debtor in the ordinary course of business of both the debtor and the transferee, and (ii) either (a) made in the ordinary course of business of both the debtor and the transferee, or (b) made according to ordinary business terms. 11 U.S.C. § 547(c)(2). The Supreme Court has held that payment made on long term debt may receive the benefit of the ordinary course of business defense. *Union Bank. v Wolas*, 502 U.S. 151, 112 S.Ct. 527 (1991).

c. Subsequent New Value Defense. The trustee may not avoid a transfer to or for the benefit of a creditor to the extent that, after the transfer, the creditor gave new value to the debtor not secured by an unavoidable security interest, and on account of which new value the debtor did not make an otherwise unavoidable transfer to the creditor. 11 U.S.C. § 547(c)(4). The subsequent new value defense most obviously applies to revolving credit arrangements. *Laher v. Vallette (In re Toyota of Jefferson, Inc.)*, 14 F.3d 1088 (5th Cir. 1994). The subsequent advance rule requires a detailed analysis of the payment history of the creditor and debtor. A *prima facie* preference to a creditor may be "offset" by a subsequent advance of credit to the debtor. *Mosier v. Ever-Fresh Food Co. (In re IRFM, Inc.)*, 52 F.3d 228 (9th Cir. 1995); *Laher*, 14 F.3d at 1092.

C. Fraudulent Transfers. Under the Bankruptcy Code, Congress authorized the court to avoid transfers that were both constructively fraudulent and actually fraudulent. 11 U.S.C. § 548.

1. Actual Fraud. The trustee may avoid a transfer of property of the debtor or the incurrence of an obligation by the debtor made within two years of the petition date and made with the actual intent to hinder, defraud or delay creditors. 11 U.S.C. § 548(a)(1). *See In re Soza*, 542 F.3d 1060 (5th Cir. 2008).

2. Constructive Fraud. The trustee may avoid a transfer of property of the debtor or the incurrence of an obligation by the debtor made within two years of the petition date if the debtor received less than reasonably equivalent value and the debtor was insolvent or became insolvent as a result of the transfer or the debtor believed it would incur debts beyond its ability to pay. 11 U.S.C. § 548(a)(2). *BFP v. Resolution Trust Corp.*, 512 U.S.1287, 114 S.Ct. 1757 (1994).

a. Payment of Debt. Payment of an existing debt is a transfer in exchange for reasonably equivalent value. *Anand v. Nat'l Republic Bank of Chicago*, 239 B.R. 511 (N.D. Ill. 1999); *Marshach v. Wells Fargo Bank*, 163 B.R. 575 (Bankr. C.D. Cal. 1994).

b. LBO's. The courts have applied fraudulent transfer law to unwind leveraged buyouts in certain circumstances. *See In re OODC, LLC*, 321 B.R. 128, (Bankr. D. Del. 2005); *In re Consolidated Capital Equities Corp.,* 143 B.R. 80 (Bankr. N.D. Tex. 1992).

c. *Durrett* Overruled. The Fifth Circuit held in 1980 that a foreclosure of real estate in exchange for 70% of the value of the real estate may be fraudulent transfers. *Durrett v. Washington Nat'l Ins. Co.*, 621 F.2d 201 (5th Cir. 1980). The Supreme Court overruled *Durrett* and held that the value received at a properly conducted foreclosure is reasonably equivalent value. *BFP*, 114 Ct. at 1765. I would observe, however, that if a creditor files a deficiency claim, the claim is still subject to attack under Tex. Prop. Code § 51.003 if the sale price is less than the "fair market value" of the property. *See* 11 U.S.C. § 502(b)(1).

D. Post-Petition Transfers.

1. General Rule. As a general matter, a trustee may avoid a transfer of property of the estate that occurs after the petition date if such transfers were not authorized by the court or the Bankruptcy Code. 11 U.S.C. § 549(a).

2. Exceptions to General Rule.

a. Lease Payments. Lease payments from a tenant debtor are authorized by 11 U.S.C. § 365(d) and are not unauthorized post-petition transfers.

b. Good Faith Purchaser of Real Estate. The trustee cannot avoid a transfer of real estate to a good faith purchaser without notice of the case if such purchaser paid fair equivalent value.

E. Strong Arm Powers. The trustee assumes the rights of a hypothetical lien creditor, judgment creditor, and good faith bona fide purchaser for value. 11 U.S.C. § 544(a). As a result of these rights, a trustee may avoid unperfected transfers of property. *See, e.g., In re Canney*, 284 F.3d 362 (2d Cir. 2002); *In re Bridge*, 18 F.3d 195 (3rd Cir. 1994); *Jones v. Salem Nat'l Bank*, 6 F.3d 422 (7th Cir. 1993). Also, the trustee assumes the rights of creditors to avoid transfers from the debtor under state fraudulent transfer laws. *See In re Mortgage Am. Corp.*, 714 F.2d 1266 (5th Cir. 1983).