

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

In re:

THOMAS JAMES MOON,

MEMORANDUM TO ORDER
DENYING MOTION OF FIRST BANK,
NATIONAL ASSOCIATION FOR RELIEF
FROM STAY

Debtor.

BKY 95-36295

This is a Chapter 7 case. On March 14, 1996, the Court entered an order denying the renewed motion of First Bank National Association ("First Bank") for relief from the automatic stay of 11 U.S.C. Section 362(a). Pursuant to Fed. R. Civ. P. 52(a) and Fed. R. Bankr. P. 9014, this memorandum sets forth the findings of fact and conclusions of law on which that order was based.

FINDINGS OF FACT

The material facts are uncontested. Many of them are aspects of the legal process by which this bankruptcy case has gone forward.

The Debtor filed a voluntary petition for relief under Chapter 7 on December 28, 1995. On his Schedule A, he noted an ownership interest in real estate located at 1728 Baihly Hills Drive, S.W., Rochester, Minnesota. This property was not, and is not, the Debtor's homestead. He did not claim it exempt for the purposes of this case. The property apparently is the site of a single-family dwelling. For some period of time prior to his bankruptcy filing, the Debtor rented this property to third persons and received rental income therefore.(FN1)

First Bank holds a mortgage against the property, and was duly scheduled by the Debtor as a secured creditor. On January 5, 1996, First Bank filed its first motion for relief from stay. Its supporting affidavit recited that:

1. Payments on the debt secured by its mortgage had been delinquent since November 1, 1994.
2. The real estate taxes for the property that were due in 1994 and 1995 remained unpaid.
3. The outstanding balance on the debt was approximately \$145,000.00.
4. The Olmsted County Assessor had assigned an estimated market value of \$127,800.00 to the property, for the purposes of real estate taxation.

Through the motion, First Bank sought leave to continue with the pending foreclosure of its mortgage, having scheduled a sheriff's sale for January 24, 1996. It also sought leave to continue pending proceedings for the appointment of a receiver for the property.

Shortly before the scheduled hearing on that motion, the Trustee, the real party in interest as to the subject asset, consented to the entry of an order that allowed the sheriff's sale to proceed but that deferred further litigation on the issue of continuing the receivership proceedings. Under the parties' agreement, First Bank could continue the receivership proceedings if the Trustee later consented or if he abandoned the subject property. First Bank also reserved the right to make a renewed motion for relief from stay.

On February 5, 1996, First Bank filed its renewed motion. The supporting affidavit recites:

1. The Olmsted County Sheriff conducted First Bank's foreclosure sale as scheduled.
2. First Bank was the successful bidder at the sale, for \$149,388.00, the full amount of the underlying debt.
3. The statutory period for redemption from the sale would run through July 24, 1996.
4. The property was currently rented, generating \$1,250.00 per month in income.
5. The delinquent real estate taxes due in 1994 and 1995 totaled approximately \$5,700.00, plus statutory penalties and interest.
6. The extant evidence as to the value of the property showed amounts ranging from \$127,000.00 (the Bank's appraisal) to \$134,000.00 (that scheduled by the Debtor for this case).

At no time before the commencement of this case did the Debtor grant the Bank an assignment of rents, issues, and profits from the subject real estate, as security for his debt to it. Since the commencement of this case, the Trustee has collected the rents from the property. He intends to do so until the redemption period expires in mid-1996.

DISCUSSION

First Bank sought relief from the automatic stay of 11 U.S.C. Section 362(a)(FN2) so it could continue its pending proceeding in the Olmsted County District Court for the appointment of a receiver. The Minnesota statute that would govern the appointment of such a receiver is, in pertinent part, as follows:

A receiver shall be appointed in the following case:

After the first publication of notice of sale for the foreclosure of a mortgage pursuant to [Minn. Stat. c.] 580, . . . and during the period of redemption, if the mortgage being foreclosed secured an original principal amount of \$100,000 or more . . . and was not a lien upon property which was entirely homesteaded, residential real estate containing four or less dwelling units where at least one unit is homesteaded, or agricultural property, the foreclosing mortgagee or the purchaser at foreclosure sale may at any time bring an action in the district court of the county in which the mortgaged premises . . . is located

for the appointment of a receiver . . . Pending trial of the action on the merits, the court may make a temporary appointment of a receiver following the procedures applicable to temporary injunctions under the rules of civil procedure. . . . The court shall appoint a receiver upon a showing that the mortgagor has breached a covenant contained in the mortgage relating to any of the following:

. . .

- (2) payment when due of prior or current real estate taxes or special assessments with respect to the mortgaged premises, or the periodic escrow for the payment of the taxes or special assessments . . .

. . .

The receiver shall collect the rents, profits and all other income of any kind, manage the mortgaged premises so to prevent waste, execute leases within or beyond the period of the receivership if approved by the court, pay the expenses listed in clauses (1), (2), and (3) in the priority as numbered, [and] pay all expenses for normal maintenance of the mortgaged premises . . . Reasonable fees to the receiver shall be paid prior thereto. The receiver shall file periodic accountings as the court determines are necessary and a final accounting at the time of discharge.

. . .

Any sums collected which remain in the possession of the receiver at termination of the receivership shall, in the event the termination of the receivership is due to the reinstatement of the mortgage debt or redemption of the mortgaged premises by the mortgagor, be paid to the mortgagor; and in the event termination of the receivership occurs at the end of the period of redemption without redemption by the mortgagor or any other party entitled to redeem, interest accrued upon the sale price pursuant to section 580.23 or section 581.10 shall be paid to the purchaser at foreclosure sale. Any net sum remaining shall be paid to the mortgagor . . .

Minn. Stat. Section 576.01 subd. 2.

As Bank points out, outside of bankruptcy it unquestionably would have grounds for the appointment of a receiver; the existing two-year delinquency in payment of real estate taxes, in violation of a mortgage covenant, satisfies Minn. Stat. Section 576.01 subd. 2(2).(FN3) The satisfaction of the state statute, however, is not the issue before this Court; the question is whether the existence of grounds to satisfy that statute constitutes "cause" for terminating the automatic stay, within the contemplation of 11 U.S.C. Section 362(d)(1).(FN4) Framed as such, the issue is a little more involved than First Bank would have it.

First Bank is correct in its threshold proposition: even though the Debtor went into bankruptcy and his interest in the subject real estate passed into an estate under federal jurisdiction, the legal incidents of the property itself, as it reposes in the estate, continue to be governed by state law. *Butner v. United States*, 440 U.S. 48, 54-55 (1979); *Saline State Bank v. Mahloch*, 834 F.2d 690, 692 (8th Cir. 1987). Under the specific holdings of *Butner* and its progeny, the right to post-bankruptcy rents earned by mortgaged

property is governed by state law. 440 U.S. at 55; Saline State Bank v. Mahloch, 834 Butner and its progeny, the right to post-bankruptcy rents earned by mortgaged property is F.2s at 692.

The remainder of First Bank's argument is more problematic. In essence, its theory is twofold: first, the cited receivership remedy protects a mortgagee from the displacement of its own lien by the perpetual statutory lien that secures delinquent real estate taxes on rental property, if such would accrue after a foreclosure sale; and second, the estate took the subject real estate with the burden of the Bank's statutory right to seek the unqualified appointment of a receiver to avoid that displacement. As First Bank would have it, if the Debtor's right to possession and control of the real estate and its rents and profits during the redemption period can be terminated by the appointment of a receiver, the Trustee's right should be no less so. These circumstances of fact and law, it argues, embody cause for relief from stay under Section 362(d)(1).

The argument is clever, and is presented in a way that is seamless to a first glance. The structure of the statute indicates that it is there to protect against "equity skimming" after a sheriff's sale--that is, the diversion of rents off mortgaged property away from the normal expenses of ownership, to the benefit of an unscrupulous mortgagor and to the detriment of the mortgagee that has to cope with the attachment of real estate tax liens, the costs of insurance, and other expenses it incurs to preserve the value and marketability of its security. While the Trustee is no such predatory figure, First Bank is not out of bounds in pointing out that the eventual outcome looks much the same--at least insofar as its interests are concerned.

However, First Bank ignores several aspects of the situation, which turn out to have as basic an impact as the fundamental principles it says it relies on.

The first is that the rents from the subject property will themselves be property of the bankruptcy estate as they are generated, until the estate's interest in the realty is extinguished at the end of the redemption period.

11
U.S.C. Section 541(a)(6).(FN5) First Bank never quite acknowledges this-- and its corollary that the Trustee has every right to fight to keep future rents in the estate, subject to his administration.

The second is that First Bank held no cognizable interest in the rents as of the commencement of this case, and holds none now. It has no contractual right to receive the rents, because it never obtained an assignment of rents and profits from the Debtor. Its right to have the rents applied to the taxes would arise only upon the appointment of a receiver, and be exercised solely through the receiver taking possession and administering the property. Minn. Stat. Section 576.01 subd. 2 does not create a property interest in the rents; it only creates a remedy for the diminution in the value of the underlying security that takes place when the state's lien for real estate taxes attaches.(FN6) It is clear from the text of the statute that no transfer of property rights in rents is effected, either by operation of law or by the appointment of a receiver--a mortgagor is entitled to recover any surplus of collected rents that remains after the receiver has administered them pursuant to the statutory priorities, whether there is a redemption or not.

Because First Bank holds no cognizable interest in the rents, it is not entitled to receive "adequate protection" in compensation for the estate's collection and retention of them. In turn, it cannot receive a grant of relief from stay on the complaint that it is not receiving such adequate protection.

(FN7) This is the unavoidable conclusion if the focus of a Section 362(d)(1) analysis is on the rents themselves as an asset.

To be entirely fair to First Bank, this may not be quite what it is arguing. It seems to posit that it can use its foreclosing-mortgagee's interest in the underlying real estate as the focal point, and then argue that the ongoing accrual of unpaid post-petition taxes is eroding the value of that interest. This argument also fails, however, for two different reasons.

The first is the suggestion that First Bank presently has some sort of a secured position against the real estate, that must be given adequate protection. As the Trustee points out, Minnesota law extinguishes the lien of a mortgage once a mortgagee has bid in the full amount of its debt, plus statutory costs, at its foreclosure sale; after that, the mortgagee holds the property as owner, subject to defeasance if the mortgagor timely redeems. E.g., *In re Schwen's, Inc.*, 19 B.R. 681, 702-703 (Bankr. D. Minn. 1981), aff'd, 693 F.2d 48 (8th Cir. 1982). First Bank exercised the legal benefit of its consensual security interest through state-law procedures, and exhausted the utility of that asset as the basis for an assertion of adequate protection rights when it foreclosed after it got its first grant of relief from stay.

Second, one can even assume First Bank's threshold assumption and the argument still does not avail. First Bank's asserted right under state statute is, really, no different from the right to commence foreclosure or replevin proceedings against any property of a bankruptcy estate, on account of a simple default in debt-payment obligations. Because of the collective nature of a bankruptcy case, such circumstances do not compel relief from stay; the real question is whether the economic value of the secured party's interest can be kept whole while the trustee administers the full (and presumably, greater) value of the asset for the benefit of all creditors.

Under this framework, First Bank may well have an alternative remedy that will protect it from any prejudice that may accrue post-petition. To the extent that real estate taxes accrue post-petition and First Bank pays them, it may be entitled to the allowance of an administrative-expense claim under 11 U.S.C. Section 503(b)(1)(A).(FN8) The Trustee has acknowledged that First Bank could assert such a claim, subject to a determination of whether it actually meets the requisites for its allowance. To the extent that such a claim is allowed, and the rental revenues exceed the total of such a claim and all other administrative expenses, First Bank would be made whole for its advance; the value of its interest as foreclosing-mortgagee-subject-to-redemption would not be reduced.(FN9) Even if First Bank's interest in the underlying real estate is linked to its hypothetical remedy against the rents for an adequate protection analysis, then, it would have its recourse through a priority unsecured claim against the estate.

There were no grounds, then, for granting First Bank the relief from stay that it sought, and its second motion was denied.(FN10)

BY THE COURT:

GREGORY F. KISHEL
U.S. BANKRUPTCY JUDGE

Dated this _____ day of
March, 1996.

(FN1) The record does not establish how long the Debtor has rented the property out. In Item 2 of his Statement of Financial Affairs, the Debtor recites that he received rental income from it "for the last seven months" preceding his bankruptcy filing. On the other hand, the subject mortgage in favor of First Bank is dated May 27, 1993, and presumably was granted in connection with the Debtor's purchase of the property.

(FN2) In pertinent part, and subject to various nonapplicable exceptions, this statute provides:

. . . a petition filed under [11 U.S.C. Section] 301, 302, 303,

. . . operates as a stay, applicable to all entities, of--

. . .

(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. . .

(FN3) This provision rather simply--but decisively--defeats the Trustee's argument that there is no statutory basis for appointment of a receiver. The lack of a consensual assignment of rents just does not matter.

(FN4) In pertinent part, this statute provides:

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from

the stay provided under. . . [11 U.S.C. Section 362(a)] . . . such as by terminating, annulling, modifying, or conditioning such stay--

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest . . .

First Bank does not rely on either of the other bases for relief from stay under Section 362(d)(2)-(3)..

(FN5) This statute provides that the "estate is comprised of," inter alia, "[p]roceeds, product, offspring, rents, or profits of or from property of the estate . . . "

(FN6) Minn. Stat. Section 272.31 provides:

The taxes assessed upon real property shall be a perpetual lien thereon, and on all structures and standing timber thereon and on all minerals therein, from the year in which the property is assessed. As between grantor and grantee, such lien shall not attach until the first Monday of January of the year next thereafter.

Analytically, lawyers and courts in Minnesota treat the state lien for real estate taxes as one automatically senior to all other encumbrances. Technically, it does not seem to be. However, because it is "perpetual," it might as well.

(FN7) In this regard--as the Trustee obliquely points out--this case is distinguishable from virtually all of the other reported decisions that have applied Minnesota's receivership and assignment-or-rents statutes in the context of bankruptcy estate administration. See, e.g., *New York Life Ins. Co. v. Bremer Towers*, 714 F. Supp. 414 (D. Minn. 1989); *In re Marion Street Partnership*, 108 B.R. 218 (Bankr. D. Minn. 1989); *In re Metro Square*, 93 B.R. 990 (Bankr. D. Minn. 1988), rev'd, 106 B.R. 584 (D. Minn. 1989); *In re Pavilion Place Assoc.*, 89 B.R. 36 (Bankr. D. Minn. 1988).

(FN8) In pertinent part, this statute provides:

(b) After notice and a hearing, there shall be allowed administrative expenses, . . . including--

(1)(A) the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the [bankruptcy] case...

(FN9) The evidence of record suggests that this would be the case; only the real estate taxes due in the first half of 1996 will accrue before the estate loses its interest in the property; in all likelihood those taxes will not exceed \$3,000.00; and the estate should collect \$6,000.00 to \$7,000.00 in post-petition rents.

(FN10) This conclusion sits well if one looks at the bigger picture also. During the hearing, it became clear that First Bank would try to use the receivership to satisfy delinquent real estate taxes accrued both pre- and post-petition. When the estate was created, however, the pre-petition taxes had already been secured by the attachment of liens against the property. Under the most basic principles of bankruptcy estate administration, the use of unencumbered post-petition revenues of the estate to pay these fully-secured component claims would have given First Bank an inappropriate windfall, an advancement over the status quo parity of claims that bankruptcy has to preserve. Too, this part of the goal might well have subverted the anti-deficiency provisions of Minnesota mortgage foreclosure laws, Minn. Stat. Section 582.30, subd. 2, just as the Trustee rather loudly argued.