Mortgagees beware: stay relief does not mean you are home free

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Trauner v. State Bank & Trust Co. (In re Solid Rock Development Corp.), 481 B.R. 221 (Bankr. N.D. Ga. 2012) –

A lender obtained relief from the automatic stay in a bankruptcy so that it could proceed with foreclosure of its mortgage. It obtained the property at the foreclosure sale with a credit bid of approximately $2 million, which included principal and interest as well as statutory attorney fees of $262,386.87. The bankruptcy trustee contended that the lender's ability to recover attorney fees was limited to a lower amount by the Bankruptcy Code, and thus the lender was required to turn over excess sale proceeds since a portion of its credit bid was not valid.

Under the applicable state statute, a note may provide for attorney fees as a specific percent of the principal and interest owing up to a maximum of 15%. If the note provides for reasonable attorney fees but doesn't specify a percent, it is deemed to mean 15% of the first $500 and 10% of the amount in excess of $500. In order to collect the statutory fees, the note holder must first notify the borrower in writing and give it 10 days to pay the principal and interest without attorney fees.

In contrast, Section 506(b) of the Bankruptcy Code provides that an over-secured creditor may include "reasonable fees" as part of its secured claim.

In this case, the lender gave the appropriate statutory notice, and the principal and interest was not paid within 10 days, so it was entitled to collect approximately $260,000 in fees under the state statute. In contrast, the trustee contended that actual reasonable fees under Section 506(b) were approximately $30,000.

In this case the order granting relief modified the stay to "allow [the lender] to exercise its rights and remedies under applicable law." After commenting that the language in its stay order was "not as clear as it could be," the court concluded that this was broad enough to permit the lender to send a notice in connection with establishing the right to statutory fees, but was not sufficient (at least in that district) to include a right to confirm the foreclosure sale under state law without regard to the bankruptcy case. After discussing the scope of its order, the court went on to caution attorneys to "be more specific in their proposed orders as to the actions to be permitted, as well as any actions the trustee or debtor clearly did not intend the lender to

take."

With respect to the interaction between state statutory attorney fees and Section 506(b) of the Bankruptcy Code, the court noted that relief from the automatic stay is not the equivalent of abandonment. The injunction prohibiting collection is lifted, but the estate's interest in the property is not released. The court then relied on an 11th Circuit case holding that statutory fees were subject to Section 506(b) in connection with asserting fees as part of a ***secured*** claim. Thus, Section 506(b) limited calculation of attorney fees for purposes of determining whether a surplus might be owed to the bankruptcy estate. (The 11th Circuit also concluded that the balance of the statutory attorney fees not included in the secured claim could be allowed as an unsecured claim permitted under state law. The *Solid Rock* court did not address this issue.)

However, finding that the attorney fee claim was limited to actual reasonable fees was not the end of the matter. The court questioned whether the credit bid was a reflection of the value of the property, and thus whether the lender actually received the statutory attorney fees as a result of its bid. While agreeing with the trustee that under state law a credit bid is viewed as cash for purposes of foreclosure, it did not follow that a credit bid was equivalent to cash for all purposes.

Consequently, while the credit bid was indicative of value, the lender was given an opportunity to show that the value of the foreclosed property was less than the amount bid. Further, if the value was greater than the principal and interest owed, then the actual reasonable attorney fees would need to be established. Only if the actual value exceeded principal, interest, and actual reasonable attorney fees would the bankruptcy estate be entitled to recover the difference.

As demonstrated by this case, obtaining relief from the automatic stay does not mean that a lender is entitled to leave the bankruptcy case behind.

It also highlights the general issue that an aggressive credit bid (meaning a bid that includes amounts that a lender may not be entitled to under the circumstances) can expose the lender to a liability to pay cash to the borrower. That is certainly an unhappy result from the lender's perspective.

Any "loan to own" purchaser interested in acquiring a note and mortgage with the goal of foreclosing and owning the property needs to be particularly sensitive to these issues. In pursuing an aggressive credit bidding strategy to make sure that it ends up with the property, these risks will need to be balanced against the desire to acquire the property. And if the mortgagor is still in bankruptcy, consider that it will have a readily available forum that is often borrower friendly for litigating claims against the purchasing creditor.

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