

11 U.S.C. §544(a)(1) & (a)(3)
O.R.S. 79.3010(1) & (4)
Land Sale Contract
Perfection
Security interest
Strong Arm Powers

Bullock v. Roost, Adv. Proc. 689-6179-R7
In re Gold Key Properties, Inc., Case No. 689-60578-R7

3/19/93

A.E.R.

Unpublished

Debtor was the owner of the vendor's interest in a land sale contract and the real property subject thereto. Debtor executed a promissory note in favor the plaintiffs and as security assigned them its interest in the land sale contract. The assignment was recorded in the county real property records, but no U.C.C. financing statement was filed regarding the assignment of the debtor's interest in the land sale contract.

After an involuntary chapter 7 proceeding was instituted against the debtor the plaintiffs commenced this adversary proceeding seeking a declaration that they held a valid and properly perfected security interest in the debtor's interest in the land sale contract and the real property. The trustee contended that he could avoid the plaintiffs' security interest by use of his strong arm powers under either 11 U.S.C. §544(a)(1) or (a)(3).

In a previous unpublished opinion (Bullock v. Roost, Adv. Proc. 689-6179-R7 (Bankr. D. Or. Oct. 5, 1990) (Radcliffe, J.), E90-7(13)) the Court held that under Oregon law the recording of the assignment in the real property records served to defeat the trustee's avoidance claim as a hypothetical bona fide purchaser under §544(a)(1), but did not defeat his rights as a hypothetical judgment lien creditor under §544(a)(3). Therefore the trustee could avoid the plaintiffs' interest in the land sale contract.

A subsequent appeal to the BAP of that decision was dismissed and the Court held a stipulated facts trial of the remaining questions.

The court held that although the plaintiffs had a valid, perfected security interest in the vendor's interest in the real property, they lacked a valid perfected security interest in the debt which the property secured. Under Oregon law the assignment of a security interest without the assignment of the debt yields the assignee nothing and hence the plaintiffs' security interest in the real property was a nullity. The court found that the

plaintiffs' interest in the land sale contract was subordinate to the trustee's.

E93-2(11)

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

IN RE)	
)	
GOLD KEY PROPERTIES, INC.,)	Case No. 689-60578-R7
)	
<u>Debtor.</u>)	
)	
MILO BULLOCK & BLANCHE BULLOCK,)	Adversary Proceeding
)	No. 689-6179-R
Plaintiffs,)	
)	
v.)	
)	
ERIC R.T. ROOST, Trustee,)	MEMORANDUM OPINION
)	
<u>Defendant.</u>)	

This matter comes before the court for trial on stipulated facts.

This adversary proceeding was brought by plaintiffs, as creditors of the debtor, Gold Key Properties, Inc., against the defendant, as the trustee in bankruptcy, herein, seeking a declaration of this court that plaintiffs hold a valid and properly perfected security interest in the debtor's interest, as vendor, in a land sale contract and the real property subject to that

contract. The plaintiffs also seek relief from the automatic stay pursuant to 11 U.S.C. § 362 and an order of this court that the defendant be required to abandon the debtor's interest in the land sale contract or initiate foreclosure proceedings due to the buyer's default.

STIPULATED FACTS

The agreed facts upon which this court is to base its decision are set forth in the stipulated facts filed herein on September 15, 1992 and the pre-trial order entered herein on May 7, 1992. Essentially, they are as follows.

On February 1, 1980, Roye A. Marshall and John H. Johnson, Jr., sold certain real property to Beverly J. Cade by way of a land sale contract. The contract and the fulfillment deed were held in escrow at First Interstate Bank, the successor in interest to Timber Community Bank. On or prior to January 6, 1984, the debtor acquired all of the rights of the vendors in the land sale contract and the real property subject thereto.

On January 6, 1984, the debtor executed a promissory note to the plaintiffs in the principal amount of \$24,015.42. In order to secure the obligation, debtor executed an "Assignment for Collateral Security of Seller's Interest in Sales Contract" (the collateral assignment). The plaintiffs recorded the collateral assignment in the real property records of Douglas County on January 11, 1984 but they have not filed a UCC financing statement

with the State of Oregon, Secretary of State's Office. There is no provision in the collateral assignment for Cade to make installment payments under the contract directly to the plaintiffs.

Paragraph 17 of the Cade contract provides in part that in the event of breach or default, seller may accelerate the debt, foreclose the contract or pursue any other right or remedy at law. Cade has failed to make installment payments under the contract since November, 1991. She is, therefore, in default.

The property in question consists of a parcel of real property and a mobile home situated thereon. According to the Douglas County Tax Assessor's Office, the property and mobile home have an assessed value of \$14,607.00. Cade has also failed to pay the Glide - Idlewyld Sanitary District assessment, therefore, there is a past due amount of \$931.00 on that assessment. Furthermore, the Douglas County Tax Assessor's Office reports that as of June 24, 1992, the real property has incurred delinquent taxes in the amount of \$1,331.92 and the mobile home situated on the property is currently \$132.85 in arrears in taxes.

To date, no payments have been made to the plaintiffs by the debtor. Since entering the contract in 1980, Cade has not made any payments to reduce the principal balance. On December 17, 1989, a total of \$31,333.38 was owing under the contract from Cade.

Paragraph 3 of the collateral assignment given to the plaintiffs by debtor provides as follows:

"In the event that assignor shall fail to perform its obligations under note (1) within thirty days of default is given, assignee shall be entitled to foreclose this assignment by a suit in equity for strict foreclosure. The parties agree that foreclosure of this assignment shall be governed by the rules governing strict foreclosure of land sale contracts rather than by the rules contained in ORS Chapter 86 governing mortgages and that the only equity of redemption of assignor shall be that fixed by the court in its final decree of strict foreclosure."

PROCEDURAL BACKGROUND

On February 27, 1989 an involuntary Chapter 7 bankruptcy petition was filed against the debtor; an order for relief was entered herein on July 14, 1989. This adversary proceeding was subsequently filed seeking declaratory relief regarding the status of plaintiff's claim to the debtor's interest in the Cade land sale contract. The parties filed cross-motions for summary judgment.

On October 5, 1990, this court entered its order granting each party's motion for summary judgment, in part and denying each party's motion, in part. That order was based upon this court's opinion entered on October 5, 1990. In that opinion, this court reviewed the respective rights of the parties based upon an opinion rendered by the Oregon Supreme Court in Security Bank v. Chiapuzio, 304 Or. 438, 747 P.2d 335 (1987).

Based upon this court's interpretation of the Chiapuzio decision, this court held that the defendant could not use his strong arm powers, as trustee, contained in 11 U.S.C. § 544 to avoid the plaintiff's asserted security interest in the real

property which is the subject of the Cade contract. This court also held, however, that pursuant to 11 U.S.C. § 544(a)(1) and (2), the defendant could avoid the plaintiff's interest in the land sale contract (that is the right to receive the contract payments).

Subsequently, an appeal was taken to the Bankruptcy Appellate Panel of the Ninth Circuit. The Panel issued its opinion on July 30, 1991, dismissing the appeal, based upon its finding that this court's order granting partial summary judgment to each of the parties is interlocutory.

The pre-trial order was entered herein on May 7, 1992. Thereafter, the parties filed their respective trial memoranda. The stipulated facts were filed September 15, 1992 and the trial was held that date at which the parties presented their oral arguments.

The plaintiffs claim that the defendant has a duty to foreclose the Cade contract, because the purchaser, Cade, is in default for non-payment. If the contract is foreclosed, their interest in the real property then has priority over the defendant-trustee's interest.

In their trial brief, however, the plaintiffs also argue that the trustee should be ordered to abandon the property to the debtor pursuant to 11 U.S.C. § 554(b) because the property is burdensome to or of inconsequential value to the estate. This assertion is based on the fact that the purchaser has not made any payments on

the contract since about November, 1990, the real property has accrued \$1,331.92 in delinquent taxes, there is \$931.00 past due on the Glide-Idlewyld Sanitary District assessment and Douglas County has threatened foreclosure. Plaintiffs assert that the property is worth only \$14,607. They argue that due to the amount of the taxes, and the plaintiff's asserted secured loan of \$24,015.42 against the property, there is no net realizable value to the estate.

The plaintiffs also assert that they are entitled to relief from the automatic stay to foreclose their assignment of the land sale contract, based upon the estate's lack of equity in the contract and the defendant's bad faith in failing to institute foreclosure proceedings against Cade.

The defendant-trustee argues that the plaintiffs' interest in the real property which is the subject of the land sale contract is a nullity, because the plaintiffs do not own the debt that it secures. The defendant also argues that he owes no obligation to the plaintiffs to strictly foreclose the Cade contract. Foreclosure would not be prudent because, the plaintiffs are claiming an interest in the property which puts a cloud on the title and which would make it impossible for the defendant to complete a foreclosure sale.

The defendant disputes plaintiffs' argument that the Cade contract is burdensome to the estate, or that there is no equity in

the contract for the estate. If the court finds that the plaintiff's interest in the real property subject to the contract is a nullity, then the property will have value to the estate which the trustee can recover.

Finally, at trial, plaintiffs', through their counsel, Wade Regier, asked this court to reconsider its prior decision granting partial summary judgment. Plaintiffs argue that this court incorrectly applied the Chiapuzio rule to this case and that present Oregon law should apply to determine the parties' rights.

ISSUES

Should this court reconsider its prior ruling of October 5, 1990, granting partial summary judgment to each of the parties?

Assuming that this court does not alter the October 5, 1990 ruling, this court must decide the parties' competing claims to the vendor's interest in the Cade land sale contract.

DISCUSSION

All statutory references are to the Bankruptcy Code, Title 11 United States Code unless otherwise indicated.

Reconsideration

During the trial of this adversary proceeding, plaintiff urged this court to reconsider its order of October 5, 1990, granting partial summary judgment. Plaintiffs contend that this court erroneously applied Oregon law to define the rights of the parties as set forth in the Chiapuzio decision, and that, in any event,

this court should apply Oregon law as it presently exists, as opposed to Oregon law in effect when the bankruptcy petition was filed, herein.

Bankruptcy Rule 9023 makes Fed. R. Civ. P. 59 applicable to adversary proceedings. Fed. R. Civ. P. 59(e) provides that "A motion to alter or amend the judgment shall be served not later than 10 days after entry of the judgment." It is clear that the plaintiffs have failed to meet the requirements of this rule. Indeed, plaintiffs have not filed any formal motion to alter or modify this court's October 5, 1990 order. They have only made an oral request at the trial on September 15, 1992. In addition, reconsideration was not one of the issues framed by the pre-trial order for the court to decide. Further, the appellants' (plaintiffs') statement of issues regarding the appeal to the Bankruptcy Appellate Panel (BAP) indicates that this is one of the issues upon which plaintiffs sought to appeal. It is clear that plaintiffs' "motion" should be denied for these procedural reasons.

In the alternative, were this court to reconsider its prior ruling, it would appear that this court correctly applied Oregon law in effect when the petition herein was filed, February 27, 1989.

Plaintiff relies upon In re Reynolds, 726 F.2d 1420 (9th Cir. 1984) and In re Combs, 101 Bankr. 609 (9th Cir. BAP 1989) for the

proposition that a court must apply the law in effect at the time it renders its decision.

While Combs and Reynolds may lend some support for the plaintiffs' position, they are both cases involving dischargeability litigation under § 523. This court's prior ruling dealt with the defendant's ability to avoid the plaintiffs' asserted security interest in the Cade contract pursuant to § 544. Unlike § 523, § 544(a) provides that the trustee's powers arise as of the "commencement of the case."

As noted in this court's prior ruling, the 1989 Oregon Legislature enacted certain amendments which became effective October 3, 1989, which, arguably, prevent future application of the Chiapuzio rule. In light of the foregoing discussion, however, this court is still persuaded that the proper Oregon law to apply in resolving this case is the Oregon law that was in effect prior to the 1989 amendments.

Plaintiffs' Interest

This court has previously held that plaintiffs have properly perfected their security interest in the vendor's interest in the real property which is the subject of the Cade contract. In addition, this court has held that the plaintiffs failed to properly perfect their security interest in the Cade contract itself or the stream of payments provided for therein. Defendant

now contends that since plaintiffs are unperfected in the contract payments, their interest in the land is a nullity.

The rights of the respective parties must be determined by applying Oregon law.

The Oregon Courts have held that where, as here, a party owns a security interest in collateral, but does not own the underlying debt secured, the security interest is a nullity. Futrell v. Wagner, 96 Or. App. 27, 771 P.2d 292 (1989); Schleef v. Purdy, 107 Or. 71, 214 P.2d 137 (1923). A holder of a security interest in realty without the underlying debt intended to be secured thereby has no remedy.

Although the plaintiffs' attempt to distinguish the case, the facts in the Futrell opinion are similar to those presented here. Futrell owned a vendor's interest in a land sale contract. Futrell assigned that interest to Busby as security for a loan. Under the assignment, Futrell retained the right to collect payments on the contract. Busby then borrowed money from Houston. In order to secure the loan, Busby executed an assignment of his assignee's interest in the land sale contract to Houston.

The Futrell court was called upon to decide what interest Houston had acquired as a result of the assignment by Busby. The court held that since Busby only held a security interest in the land sale contract and he did not assign to Houston the underlying debt that the security interest secured, Houston obtained nothing

by way of Busby's assignment. In so holding, the court stated the general rule that: "The assignment of a security interest without the assignment of the debt that it secures yields the assignee nothing." 771 P.2d 292, 294.

Here, plaintiffs have a valid perfected security interest in the vendor's interest in real property under the Cade contract, but they have not properly perfected their security interest in the stream of payments resulting from that contract, hence they have a security interest in real property, but lack a valid perfected security interest in the debt which the property secures. Hence, it would appear that the Futrell rationale is applicable here. Accordingly, it would appear that the defendant is correct and that the plaintiffs' security interest in the real property subject to the Cade contract is a nullity.

In light of the foregoing, it is obvious that the defendant should not be required to abandon the Cade contract, that the contract ought not to be abandoned by the trustee and that granting plaintiffs' relief from stay in this matter would be inappropriate.

A judgment shall be entered herein declaring that the interest of the plaintiffs in the Cade land sale contract is subordinate to those of the defendant, as the trustee, herein.

CONCLUSION

This court agrees with the defendant-trustee's assertion that the plaintiffs security interest in the vendor's interest in the

land subject to the Cade contract is a nullity for the reasons stated above. It also follows that the plaintiffs' request that defendant abandon the contract or that plaintiffs be given relief from stay should be denied. Finally, a judgment should be entered denying the plaintiffs' motion to reconsider.

ALBERT E. RADCLIFFE
Bankruptcy Judge