SALES OF REAL ESTATE AND OTHER PROPERTY OF BANKRUPTCY ESTATES UNDER THE REVISED LOCAL BANKRUPTCY RULES OF THE U.S. BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF MICHIGAN

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The Local Bankruptcy Rules governing practice before the United States Bankruptcy Court for the Eastern District of Michigan were recently revised and modified by the court. The new local rules became effective on October 1, 1998. One of the rules subject to modification was old Rule 2.22, now Rule 6004-1, which generally provides the procedure for use, sale or lease of property of the estate **other than** cash collateral. This rule contains two subsections. [1]

Subsection (a) requires that the proposed use, sale and lease of the property comply with 11 U.S.C. Section 363 and Federal Rules of Bankruptcy Procedure 2002 and 6004.

- Rule 2002(a)(2) requires a twenty-day notice to conduct a sale, use or lease of property of the estate out of the ordinary courses of business.
- Rule 2002(c) sets forth the contents of such notices and, more specifically, requires that the notice of the proposed use, sale or lease of property include the time and place of any public sale, the time fixed for filing objections and a description of the property subject to use, sale or lease.
- Rule 6004 sets forth the processes and procedures for such transactions (*e.g.*, notice, objections, sales free and clear of liens and other interests, sales of property under $2,500, hearings on objection, conducting public or private sales outside the ordinary course of business). In addition, rule 6004(f)(2) authorizes the debtor, the trustee, or debtor in possession, as the may be, to execute any instrument necessary or ordered by the court to effectuate the transfer to the purchaser after a sale in accordance with the proposed rule.

Subsection (a) of Local Rule 6004-1 requires that notice be served by the debtor in possession or the trustee. This noticing requirement represents a distinction from prior Rule 2.22, where the Clerk of the Court served the notice in Chapter 7 cases and, in all other cases, the notice was served by the movant. The notice must include a statement that the time fixed for filing objections is fifteen days from the date the notice is served. This period is consistent with the Federal Rules of Bankruptcy Procedure.

- Rule 2002(c) (1) does not set forth any specific time for filing objections but merely requires that the notice contain the time fixed for filing objections.
- Rule 6004(b) requires that objections be filed and served not less than five days before the date set for the proposed action.

ORDERS ARE NOT NECESSARY TO AUTHORIZE A TRUSTEE OR DEBTOR IN POSSESSION TO SELL ESTATE PROPERTY; THE JUDGES OF U.S. BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF MICHIGAN WILL NO LONGER, GENERALLY, ENTER SUCH "COMFORT ORDERS"

No hearing or order is "needed or contemplated" to authorize a trustee or debtor-in-possession to sell estate property. [2] In fact, the rule discourages comfort orders validating sales **unless** a timely objection

is filed and **not** "formally withdrawn." Thus, after notice, and in the absence of objections, a trustee or debtor in possession has authority to complete a sale.

The fifteen-day objection period under the new rule begins to run contemporaneously with the twenty-day noticing period contained in Federal Rule of Bankruptcy procedure 2002 (a)(2) required for the sale, use or lease of property. By running these periods contemporaneously, the process for sale of assets in the bankruptcy Court is simplified. Previously, a party seeking to sell property often filed a motion to approve the sale procedures, sold the property and then filed a motion to approve the sale of the property. Under the revised rule, the selling party need only file a notice of intent to sell the property and proof of service.

Generally, orders approving sales contained findings of "good faith" to attempt to render a post-closing appeal attacking the sale moot under 11 U.S.C. Section 363(m). Although the court will not enter a comfort order approving the sale, the court will entertain a motion from a party who requires a finding of good faith. However, as part of this motion, the court will not "approve" the sale as a subterfuge to the new local rule. The court also will not make a finding that the sale was fair and reasonable. Such determinations were not appropriate under the old rule either, and merely highlight the need to give proper notice.

The local rule, as modified, is consistent with an unpublished opinion issued by Judge Shapero on September 2, 1997, regarding comfort orders in a Chapter 7 case, *In the Matter of Lynda Crowell*, Case No. 97-43240-F. In *Crowell*, the trustee served the notice of sale for an automobile. No objections were filed, nor did anyone request a hearing. The trustee filed a certification of no response and requested that the court enter an order allowing the transfer or sale of the indicated vehicle. The court declined to enter the proffered order stating:

"The cases and legislative history relating to the enactment of Section 363(b)(1) of the Code indicated that as long as there was compliance with the notice and hearing mandate, judicial involvement is not required and approval by the Bankruptcy Court is unnecessary."

The same procedure applies to all "property of the estate," regardless of whether the property at issue is personalty or realty, tangible or intangible.

In reaching this determination, the court reviewed the legislative history. Various changes were effectuated by the Bankruptcy Code when it was enacted in 1978. Once purpose of the changes was to remove the Bankruptcy Court from the administration activities in the case and relieve the court from the burden of signing, entering, docketing, etc. orders of this type. According to Judge Shapero, the key was that "proper notice" was prepared and served and proof that no timely objections or request for hearing was filed —that is what provides the "comfort" on which purchasers can rely.

Judge Shapero was not the first to comment on the propriety of comfort orders. Indeed, as early as 1984, at least one court was already publicly lamenting the slow movement of the bar in recognizing that ordinary sales did not require orders. In *In re Robert L. Hallamore Corp*, 40 B.R.181, 182-83 (Bankr. D. Mass. 1984), the court stated:

"The 1978 Bankruptcy Code radically changed the procedure for selling property of the estate. It is now 1984 and it is time that lending institutions, conveyancing attorneys, and title companies become familiar with the Code."

* * *

"It is only out of frustration with the repeated demands of the conveyancing bar and their clients, and their total unwillingness to accept change, let alone their defiance of the plain meaning of the law, that, after some four and one half years, the Court's patience has been tried by those who still insist on 'comfort orders.'"

The local rules of the Eastern District of Michigan have thus only just caught up with the intention of the 1978 Bankruptcy Code.[3]

In *Crowell*, Judge Shapero considered titling and recording issues and dismissed those concerns by saying "there was no reason, other than unwarranted excess of caution and/or ignorance of the bankruptcy law,

why a purchaser (or title insurer or registrar of titles, etc.) needs, should ask for, or insist on anything more than verified compliance with mandated notice and service provisions, and proofs thereof, and certifications of no response or objection (filed with the court if need be)."

The bench of the U.S. Bankruptcy Court for the Eastern District of Michigan has indicated at seminars introducing the revised local rules that, generally, it will not enter comfort orders merely because the terms and conditions of the sale "require" the entry of an order approving the transaction —e.g. where the prospective purchaser or stalking horse makes it an express condition of the sale. Thus, requirements of orders in purchase agreements should be discouraged in all but the most necessary of cases.

Judge Shapero did recognize in *Crowell*, however, that there may be "those rare (very rare) instances involving a very complex matter where an actual court order would prove important or necessary." Such a circumstance was not precluded by the statutory authority, but rather, the statutory authority was designed for instances "routinely" presented to the court. This ruling by Judge Shapero is consistent with rulings in other jurisdictions. *See, e.g., In re Burd*, 202 B.R. 590 (Bankr. N. D. Ohio 1996); *Robert I. Hallamore Corp, supra*.

With regard to the sale of real property, parties should not face difficulty in obtaining title insurance for property even without an order approving the sale. Again, a comfort order is not the answer, according to the court. Rather, bankruptcy practitioners need to educate title companies that upon proper notice and adherence to defined procedures of sale, the sale was authorized and the issuance of title insurance as part of the proposed transaction is proper.

A title company's failure to issue the policy under these circumstances could result in a decision adverse to the title company. In a recent decision of the U.S. District Court for the District of Kansas, *In re Lisa, Inc,* 224 B. R. 173 (D. Kan. 1998), the trustee obtained an order approving the transfer of liens to proceeds as part of a sale of real property. After the court entered the order transferring the liens to proceeds, the title company/abstract company refused to issue a title policy free and clear of liens. Although tax liens had been transferred under the order, those liens remained a matter of record on the title policy. The buyer raised the issue in connection with the closing.

The trustee brought suit against the title company for the damages suffered as a result of an alleged breach of contract in the title company's duty to issue the abstract and the court held that the title company was liable for damages for its failure to issue the policy free and clear of liens because there was an order providing for the transfer of liens and local title standards endorsed clearing liens from title under these circumstances.

Under the revised local rule, the result should, by analogy, be no different. Thus, a title company should take care in refusing to issue title policies merely because there is no order of the court approving the sale. As long as all of the processes and procedures attendant to selling the property in Bankruptcy Court have been complied with by the parties, the title company should have no excuse in issuing the required title policy. Failure to issue a title policy under these circumstances could result in a claim for damages if the sale were upset as a result of the title company's reluctance to issue the title policy. Similarly, trustees and debtors in possession, as sellers, should take care to identify all requirements that sellers must satisfy for title policy purposes. Those requirements may include:

- certification by seller, or the opinion of seller's counsel, that proper notice was sent to authorize the sale;
- delivery of time-stamped copies of notices and proofs of service; and
- certification of the record by the court to evidence the absence of objections.

For their own protection, sellers, buyers and title companies should review closely the content of all notices and the proofs of service of these notices to assure that all creditors and other persons entitled to notice (including all persons or entities with any interest in the property to be sold) received notice.

PROCEDURES FOR OBTAINING ORDERS APPROVING SALES FREE AND CLEAR OF LIENS ARE

UNAFFECTED UNDER THE REVISED LOCAL RULES; SUCH ORDERS ARE STILL AVAILABLE

Subsection (b) of the new rule addresses sales of encumbered property when the proponent wishes to sell the property free and clear of liens, with such liens attaching to the proceeds of sale pursuant to Federal Rule of Bankruptcy Procedure 6004 (c). For the most part, the procedure under this new rule is similar to prior practice under Rule 2.22. Such relief may be granted without a hearing upon the following conditions:

- Subsection (1) requires that any notice of sale indicate that the sale is free and clear of liens and other interests, with attachment to proceeds **and also** includes a statement **that if** no objection is filed within fifteen days, authority to sell may be granted without a hearing and **if** an objection is filed and served on the movant, notice of the hearing to consider the motion will be sent the objecting party.

- Subsection (2) requires the movant to submit a certification to the court in order to sell the property free and clear, certifying that:

  -Notice was served in accordance with Federal Rule of Bankruptcy Procedure 2002 (a)(2),

  -The movant served the notice on all parties who have liens and other interests in the property to be sold (identifying each party by name and address served), and

  -No objection to sale was timely served.

  Also, a copy of the sale notice **must** accompany the certification and the proposed order.

This order will merely authorize the movant to sell the property free and clear of liens and to transfer such liens to the proceeds of sale, but will **not** contain a finding that the sale is approved by the court. Title companies, however, sometimes resist issuing policies reflecting no liens despite bankruptcy court orders. See *Lisa, supra*.[4] Practical experience with taxing authorities and registers of deeds has taught title companies that despite such bankruptcy court orders, tax liens are not automatically stricken from the record, bills are sent to new owners and claims are filed against title policies. In light of the issues raised in *Lisa, supra,* and the possible adverse consequences title companies may face by refusing to issue policies consistent with bankruptcy court orders, sellers, buyer and title companies may wish to include some (but not all) of the following requirements in their transactions:

- Require that the order transferring liens to proceeds approved by the Bankruptcy Court be in recordable form so that the order may be recorded as a matter of record title.

- Have the order transferring liens to proceeds expressly provide that the liens are transferred to proceeds of sale and, as a result of such transfer, any and all liens that are a matter of record title are extinguished or discharged upon entry and recordation of the order.

- Provide in the order transferring liens to proceeds that the order shall be recorded in order to effectuate a discharge and/or release of the tax lien on the real property.

- Obtain a letter from the taxing authority acknowledging that it received notice of the sale, the liens were transferred to proceeds, and the liens on the real property have been discharged.

- Obtain an opinion of seller's counsel that proper notice was sent to effectuate the proposed sale, and that as a result of the entry of the order transferring liens to proceeds, all liens of record have been discharged.

- Check the record and determine that all parties entitled to notice received notice of the proposed sale.

- Check the date of the matrix and the proof of service to ensure that the right matrix was utilized for noticing the sale and that all parties entitled to notice (including taxing authorities) received notice.

- Make certain that all procedures required for sale of the property and transfer of liens under the applicable bankruptcy rules have been complied with.

By understanding some or all of these actions, the title company should feel more comfortable in issuing a title policy free and clear of liens, and obtain the "comfort" that Judge Shapero addressed in the *Crowell* decision.

CONCLUSION

Revised Local Bankruptcy Rule 6004-1 brings the U.S. Bankruptcy Court for the Eastern District of Michigan in line with practices, generally, under the Federal Rules of Bankruptcy Procedure. Practitioners should educate sellers, buyers, title companies, lenders and others involved in sales of bankruptcy estate assets of the changes in practice, and encourage these persons to adopt new procedures to accommodate the changes. In short order, the memory of "comfort orders" should fade.

ENDNOTES

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1. Local Rule 6004-1 is as follows:

> (a) Except for the use of cash collateral, use, sale or lease of property of the estate shall be effected in accordance with Code Section 363 and F. R. Bankr. P. 2002 and 6004. The notice of use, sale or lease shall be served by the trustee or debtor-in-possession as the case may be. The notice shall include a statement that the time fixed for filing an objection is 15 days from the date the notice is served. Neither a court proceeding nor an order is necessary or contemplated to authorize the transactions set forth in the notice unless there is a timely-filed objection which is not formally withdrawn. The 15-day period in this paragraph begins to run contemporaneously with the 20-day notice in F. R. Bankr. P. 2002(a)(2).
>
> (b) A motion for authority to sell property free and clear of liens and other interests (with liens and interests to attach to proceeds of sale) pursuant to F. R. Bankr. P. 6004(c) may be granted without a hearing upon the following conditions:
>
> > (1) The notice of the sale shall indicate that the sale is to be free and clear of liens and other interests (with liens and interests to attach to proceeds of sale) and also include a statement that if no objection is filed within 15 days, the authority to sell may be granted without a hearing and that if an objection is filed and served on the movant, a notice of the hearing to consider the motion will be sent to the objecting party; and
> >
> > (2) Submission of a certification that:
> >
> > > (A) the notice was served on all parties as required by F. R. Bankr. P. 2002(a)(2);
> > >
> > > (B) the movant served the motion on all parties who have liens or other interests in the property to be sold (identifying each by name and address); and
> > >
> > > (C) no objection to the sale was timely served.
> >
> > A copy of the notice of sale must accompany the certification and the proposed order.

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2. Sales of joint property, where one of the parties is not a debtor, do require the commencement of an adversary proceeding. *See, e.g.*, F. R. Bankr. P. 7001(3) and Section 363(h) of the Bankruptcy Code. When such interests cannot be partitioned, in order to sell both the interest of the estate and the non-debtor co-owner in the property, an adversary proceeding must be commenced and a determination made by the court. Such sales may not be effectuated through new Local Rule 6004-1.

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3. According to the Administrative Office of the U.S. Courts ("AO"), most districts now decline to issue comfort orders as a general practice, and the trend appears to be for more districts to adopt that preference. The AO, however, does not maintain statistics concerning this practice.

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4. In *Lisa, supra,* the title company alleged numerous defenses to the action by the trustee. The title company challenged the trustee's standing to bring the claims, contending that the trustee was not a beneficiary under the insurance contract to be issued. The court first noted that the trustee was not suing under the insurance contract, and then concluded the trustee was entitled to standing because he was paying for the policy, and if an acceptable policy was not issued he would suffer damages. Moreover, the court found that by arranging to provide a title abstract and title binder, and agreeing to pay part of the cost, the seller, in this case, the trustee, had entered into a contract in which the title company had implicitly agreed to perform services consistent with the ordinary standards used in that locale and therefore, should be accorded standing.

The title company contended that it was free to impose any conditions it wanted in the policy. The court dismissed this argument and held that the title company had an implied duty of good faith and fair dealing to provide a title policy that met the ordinary standards promulgated by the Kansas Bar Association. In reaching this conclusion, however, the court did acknowledge that under precedents from other jurisdictions, the title insurer had no "implied obligation" to insure over title defects or risks that it had identified. Those cases were distinguished based upon the applicable local standards in effect.

The title company was also concerned that it could face future liability for claims and risks insured over the record title. In response to this concern, the court indicated that the title ompany would have recourse against the seller, here being the trustee in bankruptcy. The court failed to recognize, however, that by the time the claim arose, the trustee may have already distributed all the assets of the estate, and **therefore would be judgment proof**. It would appear, though, that the title company could assert res judicata or collateral estoppel against a taxing authority that sought to maintain the tax lien on the property, in reliance upon the entry of the prior bankruptcy court order transferring the liens to proceeds. Of course, the risk and expense of having to raise this issue was at least one reason why the title company resisted issuing a clean policy in the first place.

(A version of this article was included in seminar materials presented by the authors as a "Hot Tip" at the Michigan State Bar Real Property Law Section's Homeward Bound Seminar on January 21, 1999 entitled *Avoiding and Resolving Title Problems*.)

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