United States Bankruptcy Court
District of New Mexico

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW MEXICO

In re:
KARLA A. ROYBAL and
REYNALDO J. ROYBAL,
Debtors. No. 7-99-15513 SS

CENTURY BANK, FSB,
Plaintiff,
v. Adv No. 99-1216 S

HERITAGE PARK, INC., et al.,
Defendants.

MEMORANDUM OPINION ON TRUSTEE'S MOTION FOR SUMMARY JUDGMENT

This matter is before the Court on the Trustee's Motion and Brief for Summary Judgment on Crossclaim Against Heritage Park, Inc. (doc. 22), the Amended Response to Trustee's Summary Judgment Motion (doc. 31)[1] filed by Heritage Park with its accompanying Affidavit of Paul Stein (doc. 33), and the Trustee's Reply to Heritage Park's Amended Response (doc. 35). The issues in this case involve the Trustee's ability to avoid a statutory landlord's lien under Bankruptcy Code Section 545 and the construction of the terms of a lease agreement.

[1] The Amended Response fails entirely to comply with the portion of NM LBR 7056-1 which requires that "[e]ach fact in dispute shall...refer with particularity to those portions of the record upon which the opposing party relies, and shall state the number of the movant's fact that is disputed. All material facts set forth in the statement of the movant shall be deemed admitted unless specifically controverted." Although completely ignoring the rules is a sufficient ground for the Court to grant the Trustee's relief in this instance, the Court has decided to resolve the matter on its merits.

Having considered the Motion for Summary Judgment and the related documents, as well as the Complaint, answers, crossclaim and counterclaim and the answers thereto, and the Exhibit A to the Crossclaim and Counterclaim, and being sufficiently advised, the Court finds that Trustee's Motion is well taken.

Facts

Debtor Karla Roybal did business as Styles de Santa Fe at 112 W. San Francisco Street, Santa Fe, New Mexico. On April 1, 1996 she executed a promissory note to Century in the amount of $50,000 (exhibit 1 to complaint) and a Commercial Security Agreement (exhibit 2) which granted Century a security interest in all her inventory, accounts, general intangibles, furniture and fixtures, wherever located, after acquired property, and in proceeds. Century filed a financing statement (exhibit 3) with the Secretary of State to perfect its interest. On April 1, 1997, Karla Roybal executed a promissory note (exhibit 4) to Century in the amount of $55,000 and a Commercial Security Agreement[2] (exhibit 5) which granted Century a security interest in "inventory, furniture

[2] Trustee's Answer to Crossclaim denies the Commercial Security Agreement was delivered on April 1, 1997 because it is dated March 17, 1997. This factual dispute is not material.

and fixtures located at 112 W. San Francisco Street, Santa Fe, New Mexico" and all replacements, substitutions, and proceeds.

On or about April 15 or 17, 1997, Karla Roybal opened a second store at 128 West Water Street, Santa Fe, New Mexico[3]. Heritage was the landlord for the 128 West Water Street store. The lease was dated March 13, 1997.

In February, 1999, Heritage, Century, Karla Roybal, and Reynaldo Roybal entered into an Agreement for Relocation of the Goods and Preservation of Liens, Claims and Defenses (Exhibit A, doc. 14). This agreement provides, in part:

> **Recitals**
> ...
> D. Certain inventory, equipment and other goods owned by Ms. Roybal remain on the premises at 128 West Water Street, Santa Fe, New Mexico ("128 West Water Street"). Heritage claims a landlord's lien on the personal property of Ms. Roybal at 128 West Water Street under NMSA 1978, Section 48-3-5.
> E. The parties wish to provide for removal of the personal property at 128 West Water Street to Plaza Mercado, 112 West San Francisco Street, Suite 202, Santa Fe, New Mexico, while preserving their respective claims and defenses, and therefore agree as set out below.
> **Agreement**
> 1. Heritage will permit Ms. Roybal to remove the inventory and equipment and other property of Styles de Santa Fe from 128 West Water Street ... to Plaza Mercado ...
> 2. The parties agree that the landlord's lien claimed by Heritage, the security interest claimed

[3] Trustee lacked information and therefore denied this allegation in both the complaint and crossclaim; the date is not material.

> by Century, and all claims and defenses of each party with respect to any other party, shall not be improved or diminished, increased or decreased, or affected or modified in any way as a result of removal of the inventory and equipment from 128 West Water Street. Ms. Roybal and Century agree in particular that any landlord's lien now held by Heritage shall not be avoided by removal of the inventory and equipment. If it is ever determined that the foregoing stipulation is for any reason ineffective to preserve or continue any lien held by Heritage, then Ms. Roybal grants to Heritage a replacement security interest in the inventory and equipment now located at 128 West Water Street and to be removed to the new location under paragraph 1, above, that is identical in every respect, including priority, to any lien now held by Heritage, and Century acknowledges that security interest.
> 3. The parties anticipate entering into a separate agreement for liquidation of the inventory...

The property was moved and subsequently sold, and the proceeds of the sale, approximately $46,500, remain in an account. The Debtors later filed their chapter 7 petition, on September 30, 1999.

Conclusions of Law

New Mexico has a statutory landlord's lien, § 48-3-5(A) NMSA 1978 (1995 Repl.):

> Landlords have a lien on the property of their tenants that remains in or about the premises rented, for the rent due by the terms of any lease or other agreement in writing, and the property shall not be removed from the premises without the consent of the landlord until the rent is paid or secured. A lien does not attach if the premises rented is a dwelling unit.

Trustee's Motion for Summary Judgment seeks a determination that Heritage's lien is a statutory landlord's lien avoidable by the trustee under 11 U.S.C. § 545. That section provides, in part:

> The trustee may avoid the fixing of a statutory lien on property of the debtor to the extent that such lien–
>
> ...
>
> (3) is for rent; or
>
> (4) is a lien of distress for rent.

The intent behind the quoted bankruptcy statute is clear. Congress intended that landlords be treated as unsecured creditors in bankruptcy proceedings. See 3 Norton Bankr. L. & Prac. 2d § 55:2 ("Under prior bankruptcy laws, the invalidation of landlord's liens was coupled with a grant of limited priority for certain landlord claims. The priority status has been deleted under the Code, but the lien invalidation is retained. Thus a lessor may be reduced to the status of a general unsecured creditor.")(footnotes omitted.);

> [A] lien for rent or of distress for rent is voidable, whether the lien is a statutory or common law lien of distress for rent. *See* proposed 11 U.S.C. 101(37); Bankruptcy Act § 67(c)(1)(C)[4]. The trustee may avoid a transfer of a lien under this

[4] Former Bankruptcy Act §67(c)(1)(C) provided: "The following liens shall be invalid against the trustee ... (C) every statutory lien for rent and every lien of distress for rent whether statutory or not. A right of distress for rent which creates a security interest in property shall be deemed a lien for the purposes of this subdivision c."

> section even if the lien has been enforced by sale before the commencement of the case. To that extent, Bankruptcy Act § 67c(5)[5] is not followed, and cases implying a similar restriction with respect to Bankruptcy Act § 67a are overruled.

H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 371 (1977), reprinted in App. C, Collier on Bankruptcy (15th Ed. Rev.), Pt. 4(d)(i) at 4-1510. See also 5 Collier on Bankruptcy ¶545.04 at 545-14, 15 (15th Ed. Rev.)(Section 545 allows the trustee to avoid a statutory lien for rent or lien of distress for rent regardless of when it became effective, whether or not it is perfected against third parties or bona fide purchasers, and whether or not it enhances the value of the estate and whether or not the lien has been enforced by sale prior to the filing of the petition.)

The facts are undisputed that Heritage was the landlord and that Heritage had a lien on property of the debtors for payment of rent. Heritage argues that, because the collateral was sold prepetition, there was no property of the estate on which the trustee could avoid its lien because § 551 "applies only to property of the estate." Amended Response, at 6 (doc. 31). The Court disagrees with Heritage's argument.

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[5] Former Bankruptcy Act § 67c(5) provided: "This subdivision c shall not apply to liens enforced by sale before the filing of the petition..."

First, § 551 deals with preservation of avoided transfers for the benefit of the estate: "Any transfer avoided under section...545...is preserved for the benefit of the estate but only with respect to property of the estate." Section 101(54) defines "transfer" as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property,..." The taking of the landlord lien was a transfer. "The Bankruptcy Code contemplates that when a lien is granted, there has been a transfer of property." In re Greater Southeast Community Hospital Foundation, Inc., 237 B.R. 518, 521 (Bankr. D.C. 1999).

Section 551 does not limit the trustee's avoidance or recovery powers. The relevant section is § 550(a), which states "to the extent that a transfer is avoided under section ... 545 ..., the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property ..." See In re Greater Southeast Community Hospital Foundation, Inc., 237 B.R. at 522:

> The avoided lien itself is not brought back into the estate under § 550, but only the property transferred to effect the creation of the lien. To answer the question of whether the property recovered by the trustee (or the debtor-in-possession acting with the powers of a trustee) would have any benefit for the estate, the court turns to § 551 of the Bankruptcy Code, which deals

> with the distinct question of whether the lien itself may be preserved for the benefit of the estate. ... Section 550 pulls that property back into the estate. Then § 551 preserves the lien for the benefit of the estate.

Upon avoidance of Heritage's lien, the proceeds in the account become property of the estate. See 11 U.S.C. § 545(3)&(4)(Trustee may avoid lien for rent or distress of rent.); 11 U.S.C. § 550 (If transfer avoided under section 545, trustee may recover the property transferred or its value.); 11 U.S.C. § 541(a)(3) (Estate includes any interest in property the trustee recovers under section 550.) See also C&C Company v. Seattle First National Bank (In re Coal-X Ltd. "76"), 60 B.R. 907, 913 (Bankr. D. Ut. 1986)("The landlord's lien avoided by the trustee constitutes property of the estate.") Therefore, the requirement that the lien be preserved "only with respect to property of the estate"[6], 11

[6] "The purpose of the limitation that the avoided interest be preserved 'only with respect to property of the estate' is 'to prevent the trustee from asserting an avoided lien that floats, such as a tax lien, against after-acquired property of the debtor.'" Dunes Hotel Associates v. Hyatt Corporation, 245 B.R. 492, 502 (D. S.C. 2000)(citation omitted).

> The phrase, 'only with respect to property of the estate,' has been construed to mean that an avoided transfer becomes property of the estate only if the avoided transfer involves estate property. This construction is wrong. The clear purpose of the phrase is to limit only the subrogation powers of section 551, not to restrict the reach of sections 551 and 541 in bringing avoided transfers within the bankruptcy estate.

U.S.C. § 551, is satisfied because the proceeds have, in fact, become property of the estate. Greater Southeast Community Hospital Foundation, 237 B.R. at 522.

Second, the proceeds in the account are presumptively property of the estate in any event.

> [W]e cannot ignore the Supreme Court's comment that the turnover provision "may" not apply if a levy transfers ownership of the levied-upon property to the creditor. We cannot assert that Whiting Pools [United States v. Whiting Pools, 462 U.S. 198 (1983)] requires all property seized pre-petition to be included in the property of the debtor's estate. Instead, we believe that Whiting Pools creates a presumption that all property levied upon pre-petition is included in the debtor's estate, and unless the creditor can show that the levy completely transferred ownership of the property to the creditor, leaving the debtor with no remaining interest, the property must be returned to the estate.

SPS Technologies, Inc. v. Baker Material Handling Corporation, 153 B.R. 148, 152 (E.D. Pa. 1993). There are no allegations that ownership of the funds was transferred to Heritage or

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Id., at 502-503. This "wrong construction" is precisely the argument that Heritage makes. See also Losieniecki v. Thrift Consumer Discount Company, 17 B.R. 136, 140 (Bankr. W.D. Pa. 1981)(Language prevents trustee from asserting an avoided tax lien against after-acquired property of the Debtor which is not estate property.) See also 124 Cong. Rec. H11097 (daily ed. Sept. 28, 1978), reprinted in App. D, Collier on Bankruptcy (15th Ed. Rev.) Pt. 4(f)(i) at 4-2449 ("This prevents the trustee from asserting an avoided tax lien against after acquired property of the debtor."); 124 Cong. Rec. S 17414 (daily ed. Oct. 1978), reprinted in App. D, Collier on Bankruptcy (15th Ed. Rev.) Pt. 4(f)(iii) at 4-2563 (same quote.)

Century. Indeed, the allegations are that the funds are still in an account subject to the liens of Century and Heritage.[7]

Under Heritage's reading of section 551, all the trustee's avoiding powers would be limited only to actions for a return of property which was already property of the estate. However, if property is already property of the estate there is no need for a statute that allows an action that seeks the return of property to the estate. Section 550 and all of the trustee's avoiding powers would be meaningless.

To the extent that Heritage's lien attaches to the proceeds in the account, the Trustee may avoid Heritage's lien if it is for rent or distress of rent. While the collateral itself may have been sold, Heritage's lien attached to the

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[7] Heritage argues that "[t]he property in question liquidated for benefit of Heritage and Century pre-petition is not and was not ever a part of the bankruptcy estate." Amended Response at 6. Paragraphs 1 and 2 of the Relocation Agreement, to which the now-Debtors were parties, specifically preserve "all claims and defenses of each party" to "the inventory and equipment and other property". The inventory, equipment and other property were converted into the cash proceeds over which the parties are now arguing. Thus, considering the proceeds of the sale of the goods to be the property in question, the statement is clearly inaccurate. On the other hand, if Heritage means to argue that the sale of goods deprived the Debtors of any claim to a share of the proceeds of the sale, Amended Response at 7 and 11, Heritage has cited no facts that would support that remarkable proposition. Heritage certainly argues to the contrary with respect to its own lien. Amended Response at 6.

traceable proceeds, which have not been paid over[8]. See also Driskill v. Hutchinson, Hutchinson and Hudgins (In re Furniture Discount Stores, Inc.), 11 B.R. 5, 7 (Bankr. N.D. Tx. 1980)("The legislative history reflects that, according to both the House Reports and the Senate Reports, the trustee may avoid a transfer of a lien under [§ 545] even if the lien has been enforced by sale before the commencement of the case.")

Heritage's next argument is that its lien is not a landlord's lien; rather, it claims that "Century Bank, by filing this action in the Bankruptcy, and the Trustee, by joining therein and moving to avoid Century's [sic] statutory lien, have triggered the above referenced paragraph of the [Agreement for Relocation of Assets]. Said Agreement is a Consensual Security Agreement." Amended Response, ¶¶15-16 (doc. 31). In other words, Heritage urges that because its landlord's lien has been challenged, the Relocation Agreement becomes a consensual security agreement and thus not subject

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[8] This case might be different if the collateral had been liquidated and the proceeds distributed to Century and Heritage in advance of the bankruptcy filing and not otherwise subject to challenge (e.g. as a preference). See, e.g. Nationsbank N.A. v. Ames Savings and Loan Assn. (In re First American Mortgage Co., Inc., 212 B.R. 479, 485-86 (Bankr. D. Md. 1997)(Funds properly setoff prepetition are not part of the estate and trustee may not recover under sections 551, 544, or 545.)

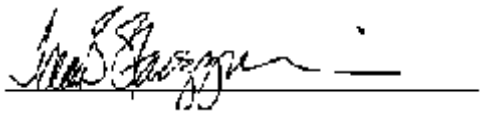
to the provisions of §545(3) and (4), which deals with statutory liens only. This argument also fails.

First, the intent of the relocation agreement was to create a "replacement" security interest that "is identical in every respect including priority to any lien now held by Heritage". In other words, the landlord lien would still be a landlord lien, but just called a security interest. For the Court to treat this new security interest as somehow different from a landlord's lien would not only disregard the explicit language of the Relocation Agreement; it would also elevate form over substance. See Marshall v. Aubuchon (In re Marshall), 239 B.R. 193, 197 (Bankr. S.D. Il. 1999)(Lease contracts referred to state's statutory landlord provision and did not modify those rights in any way, so that the leases merely recited what rights the landlord received by statute. The Court concluded that despite the lease contracts, the landlords possessed only statutory liens which were subject to avoidance under § 545.). Compare In re A & R Wholesale Distrib., Inc., 232 B.R. 616, 621-22 (Bankr. D. N.J. 1999)(State court order confirming sale of tenant's property does not transform statutory landlord's lien into judicial lien.)

Second, and more important, the Relocation Agreement provides that "if it is ever determined" that Heritage's lien is ineffective, "then Mrs. Roybal grants to Heritage a replacement security interest." There is no allegation that there has ever been such a determination. When the bankruptcy was filed, Heritage's status was locked in as to its lien. The collateral, or its proceeds, were vested in the bankruptcy estate as a matter of law. Ms. Roybal no longer had the power or authority to grant a replacement lien with respect to the collateral. Only the Trustee could grant a replacement security interest, which the Trustee has not done. Furthermore, to the extent that Heritage argues that this replacement lien arose per the Relocation Agreement upon the filing of the bankruptcy, the automatic stay would prevent such an act. See 11 U.S.C. § 362(a)(4)(The bankruptcy petition operates as a stay against any act to create, perfect, or enforce any lien against property of the estate.) See also 11 U.S.C. § 549(a) (Trustee may avoid unauthorized post-petition transfers of property.); U.S.A./FmHA v. Indi-Bel, Inc. (In re Williams), 167 B.R. 77, 82 (Bankr. N.D. Ms. 1994)(Attempted perfection post-petition is a voidable transfer under § 549(a)(1).) Therefore, Heritage's only lien is its landlord's lien. The replacement security interest was

never granted. Therefore, all of Heritage's arguments regarding the uniform commercial code, bailments, and constructive possession are moot because they are founded upon the assumption that there was an enforceable consensual lien in addition to the landlord's lien.

For the reasons set forth above, the Court finds that Trustee's Motion for Summary Judgment should be granted.[9] The Court will enter an Order granting the motion.



Honorable James S. Starzynski
United States Bankruptcy Judge

[9] Heritage also argues that its lien should not be avoided for the "policy" reason that the proposed settlement between Century and the Trustee, premised on the avoidance of Heritage's landlord's lien, is not a good enough deal for the estate. Amended Response, at 11-12. The advisability or not of the proposed settlement has nothing to do with whether §545 requires the avoidance of Heritage's lien.

I hereby certify that, on February 26, 2001, a true and correct copy of the foregoing was either electronically transmitted, faxed, delivered or mailed to the listed counsel and parties.

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