UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re

JOSEPH F. FERRELL and
LISA C. FERRELL,

Joint Case No. 93-33162-K
Chapter 13

Debtors.

JOSEPH F. FERRELL and
LISA C. FERRELL,

Plaintiffs,

vs.

Adv. Proc. No. 94-0154

SOUTHERN FINANCIAL, INC.,

Defendant.

MEMORANDUM RE PLAINTIFFS' COMPLAINT TO SET ASIDE HOME FORECLOSURE SALE COMBINED WITH NOTICE OF THE ENTRY THEREOF

In this adversary proceeding the plaintiffs, Joseph F. Ferrell and Lisa C. Ferrell, the above-named chapter 13 debtors ("Debtors"), seek to set aside a foreclosure of their home.

Pursuant to Fed. R. Bankr. P. 7012(c) the parties have requested the Bankruptcy Court for a judgment on the pleadings. Cf. Fed. R. Bankr. P. 7056. Thus, the core/non-core dichotomy under 28 U.S.C. §157(b) and (c) is not relevant.

ISSUES PRESENTED

The narrow and ultimate issue for judicial determination in this proceeding is whether or not the debtors may set aside a home foreclosure; cure the economic defaults owed to the defendant, Southern Financial, Inc. ("SFI"); and reinstate the terms of the home mortgage under section 1322(b)(5) of the Bankruptcy Code.

This Memorandum only addresses a threshold issue: When does a foreclosure sale under Tennessee law become final and consummated? That is, at what point in the non-judicial foreclosure process under Tennessee law does a foreclosure sale become final -- at the time the indenture trustee accepts the highest bid at a scheduled foreclosure; upon expiration of the redemption period; upon transfer of the deed and payment of the consideration; or upon recordation of the indenture trustee's deed. In the instant proceeding the answer to this threshold question will determine whether the debtors have the right to cure their home mortgage default under the rationale of In re Glenn, infra, and section 1322(b)(5) of the Bankruptcy Code and thereby save their home or whether those rights have terminated?

BACKGROUND FACTS

Based on the parties' joint stipulation of facts filed on March 14, 1994, and considering the case record as a whole, the following shall constitute the Court's findings of fact and conclusions of law in accordance with Fed. R. Bankr. P. 7052.

The relevant background facts are not in dispute and may be briefly summarized as follows: Debtors purchased their home located at 6097 Glascony Drive, Memphis, Tennessee in August 1991 for a cash price of $70,000.00. On December 1, 1992, the debtors obtained a non-purchase money loan from SFI in the amount of $20,000.00, bearing 15% annual interest, payable in monthly installments of $351.00 commencing on January 1, 1993, for a period of ten years. To secure this loan, the debtors granted SFI a first mortgage on their home.

Due to subsequent economic defaults, SFI exercised its contractual rights and commenced a foreclosure action against the debtors' home which was scheduled to be held at 12:00 o'clock noon on December 10, 1993. SFI's bid of $22,000.00 was the highest and successful bid at the non-collusive, regularly-conducted foreclosure. At approximately 4:32 p.m. on December 10, 1993, the same date as the foreclosure, the debtors filed an original section 302 petition under chapter 13 of the Bankruptcy Code accompanied with a repayment plan which proposed, inter alia, to maintain ongoing monthly contractual

payments to SFI, to cure all the economic defaults and reinstate the terms of the mortgage held by SFI under section 1322(b)(5) of the Bankruptcy Code and to pay all other creditors 100% of their claims. Debtors' Schedule A herein reflects that their home has a fair market value of $72,000.00.

On December 13, 1993, without actual knowledge of the debtors' chapter 13 case, SFI's substitute indenture trustee innocently executed and registered a "Substitute Trustee's Deed" pursuant to TENN. CODE ANN. §66-24-101.

On February 16, 1994, the debtors filed the instant complaint seeking to set aside SFI's foreclosure of their home.

DEBTORS' POSITION

Debtors essentially contend that the subject foreclosure was not final, and therefore any interest they may have in the home was not terminated, at the time their chapter 13 case was commenced. They seek an opportunity to cure the economic defaults owed to SFI under 11 U.S.C. §1322(b)(5); save their home; and pay all creditors 100% of their claims.

SFI'S POSITION

SFI's position is contrawise. It contends, inter alia, that the subject foreclosure is final and that the rights of the debtors to cure the economic defaults and reinstate the home mortgage have terminated.

11 U.S.C. §541(a)

11 U.S.C. §541(a) broadly defines property of a debtor's estate as including "all legal or equitable interests of the debtor in property as of the commencement of the case." U.S. v. Whiting Pools, Inc., 462 U.S. 198 (1983).

It has been said that although federal bankruptcy law determines the outer boundary of what may constitute property of the estate, State law determines the "nature of a debtor's interest" in given property. See, e.g., In re Howard's Appliance Corp., 874 F.2d 88, 93 (2nd Cir. 1989). The Supreme Court has

emphasized that "Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law." Butner v. United States, 440 U.S. 48, 54 (1979). In Butner the Supreme Court stated:

> "Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving `a windfall merely by reason of the happenstance of bankruptcy.' Lewis v. Manufacturers National Bank, 364 U.S. 603, 609, 81 S.Ct. 347, 350, 5 L.Ed.2d 323. The justifications for application of state law are not limited to ownership interests; they apply with equal force to security interests...."

Id. at 55. Thus, absent a countervailing federal interest, "the basic federal rule is that state law governs." Id. at 57.

IN RE GLENN

In In re Glenn, 760 F.2d 1428 (6th Cir. 1985), cert. den. 474 U.S. 849 (1985), the debtors filed a chapter 13 petition after the mortgagee had obtained a foreclosure judgment under Ohio judicial foreclosure law but before the sheriff sold the real estate. The Sixth Circuit held, inter alia, that "[o]nce the property had been sold, the right to cure the default and reinstate the terms of the mortgage under section 1322(b) ceases."

The Glenn decision, it appears, actually provides little guidance in the instant proceeding because here the gravamen of the concern centers around what constitutes "the [foreclosure] sale". Once it is determined when the foreclosure sale is final or consummated, if at all, then Glenn dictates the result.

POWER OF SALE FORECLOSURES IN TENNESSEE

Most often real estate is financed by the mortgagor who extends a security interest in the property to be purchased in favor of the mortgagee. This is done in Tennessee with a deed of trust executed by the debtor-mortgagor to an indenture trustee who holds the property as security for the repayment of the

debt. The deed of trust normally contains a provision which enables the indenture trustee to hold a foreclosure sale upon the mortgagor's failure to pay for the property. This is a non-judicial foreclosure procedure conducted pursuant to the terms agreed upon by the parties. One advantage of this arrangement over the judicially supervised foreclosure procedure is that it is far less expensive.

Tennessee statutory law governing power of sale clauses is sparse because the power of sale as recognized at early common law is basically a creature of contract between the parties. See Note, Wesley D. Turner, *"Power Of Sale Foreclosure In Tennessee"*, 8 Mem. St. L. R. 871 (1978). The right to create such an agreement has been recognized at common law and only regulated to a limited degree by statute.

It has been stated that due to the high possibility of abuse under non-judicial power of sale foreclosures, such sales must be, "most jealously watched by a court of equity, and upon slight proof of unfair conduct be set aside." Pugh v. Richmond, 58 Tenn. App. 62, 77, 425 S.W.2d 789, 796 (1967), quoting Mitchell v. Sherell, 11 Tenn. App. 210, 221 (1929). As stated in Mr. Turner's Note dealing with power of sales clauses, Tennessee's hands-off treatment of such non-judicial sales makes defaulting debtors vulnerable to unfair treatment by creditors. Id. at 891.

In light of the Tennessee Supreme Court's instruction in both the Pugh and Sherell cases, non-judicial foreclosure sales should be carefully scrutinized for any wrongdoing, benevolent or otherwise, which might jeopardize an unfortunate debtor's position. Any cause to invalidate a power of sale foreclosure should be considered. For example, failure to satisfy the Tennessee statute of frauds has been held a valid reason to set aside a non-judicial foreclosure sale. Watson v. McCabe, 381 F.Supp. 1124 (D.C. M.D. Tenn. 1974). Pursuant to the statute of frauds pursuant to TENN. CODE ANN. §29-2-101 no action shall be brought upon contracts for the sale of land unless such transaction is evidenced by a writing.

In Watson v. McCabe, supra, an indenture trustee brought suit seeking specific performance of a contract for sale of realty arising from a foreclosure sale conducted pursuant to the terms of the deed of trust. The United States District Court held, inter alia, the indenture trustee's filing a complaint incorporating

the terms of an oral contract did not satisfy the requirements of the statute of frauds, TENN. CODE ANN. §29-2-101, and even if it did, no written memorandum evidencing the transaction was signed by the trustee, thus, the contract for sale could not be specifically enforced.

In McCabe the court noted that the transaction may be put in writing at any time after the contract and before suit is brought. Watson v. McCabe, 381 F.Supp. at 1129. Quoting Hudson v. King, 49 Tenn. 560 (1870), the McCabe court reasoned that the writing must contain the essential terms of the contract with sufficient certainty to show the intention of the parties without resorting to parol evidence. Watson v. McCabe, 381 F.Supp. at 1130. See Fortner v. Wilkinson, 357 S.W. 2d 63 (1962) (holding that the sale of land by a trustee under authority of trust deed is within purview of statute of frauds). See also Jameson v. Kimbrough, 354 S.W. 2d 458 (1962) (the highest bidder at a mortgage foreclosure sale acquires no title to the thing purchased but by payment of purchase money). Contra, In re Pearson, 75 B.R. 254 (Bankr. N.D. Ga. 1985); In re Sanders, 108 B.R. 847 (Bankr. S.D. Ga. 1989); In re Morgan, 115 B.R. 399 (Bankr. M.D. Ga. 1990).

FORCE AND VALIDITY GENERALLY OF ACTS IN COURSE OF SUPERSEDED ADMINISTRATION

5 Remington on Bankruptcy, §2104, pp. 214-215 (Henderson), provides in relevant part as follows:

> "[t]he fact that an assignment for creditors or a receivership is superseded by bankruptcy of the debtor does not mean that it was void ab initio...wholly completed sales of assets made in the assignment or receivership proceedings would accordingly seem to remain unaffected, but if the property has not been paid for title thereto passes to the bankruptcy trustee and the property may not be recovered except by plenary action. A sale which has not been duly confirmed...can be vacated by the bankruptcy court...."

CONCLUSIONS

Considering a totality of the particular facts and circumstances, it appears, in the Glenn context, that the Tennessee courts have not expressly addressed the exact point at which a non-judicial

foreclosure sale becomes final and consummated. Is it at the time the indenture trustee accepts the highest bid at a scheduled foreclosure; upon expiration of the redemption period; when the indenture trustee executes a deed after receiving the highest bid at a properly advertised private foreclosure and payment of consideration; or is it when the indenture trustee's deed is registered? As such, the question may be one incapable of resolution through reference to existing statutory or case law, but rather one which must be based, like Glenn, on sound pragmatic principles which do the least equitable violence to the competing and countervailing interests.

It has been held that the receipt of a bid at a foreclosure sale merely forms a contract between the bidder and the debtor to purchase the property at bid price. See, e.g., F.D.I.C. v. Dye, 642 F.2d 837, 843 (5th Cir. 1981) (holding that a foreclosure sale is not final "unless the deed is transferred"). That contract is not itself an actual conveyance as the "crying of a sale" on the courthouse steps is only a step toward finalizing a foreclosure sale and does not, ipso facto, serve as evidence of a consummated foreclosure sale. See also, e.g. McKinney v. South Boston Savings Bank, 156 Ga. App. 114, 274 S.E. 2d 34 (1980).

Here, it must be noted and emphasized that SFI's indenture trustee had not executed the deed (or similar memorandum required by the Tennessee statute of frauds) at the time the chapter 13 case was commenced. Thus, the Court finds and concludes that the subject foreclosure sale was not final, and therefore any interest the debtors may have in their home was not terminated at the time the chapter 13 case was filed. Accordingly, the debtors indeed have a right to seek to cure the economic defaults under section 1322(b)(5) of the Bankruptcy Code and In re Glenn rationale and to reinstate the terms of their home mortgage.

As mentioned earlier, the indenture trustee's deed here was executed and registered after the filing of the chapter 13 case. In In re Smith, 876 F.2d 524 (6th Cir. 1989), the Sixth Circuit stated at pp. 525-526 as follows:

> "Under section 362(a) of the Bankruptcy Code, the filing of a petition creates a broad automatic stay protecting the property of the debtor. This provision has been described

> as one of the fundamental debtor protections provided by the bankruptcy laws. Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494, 503, 106 S.Ct. 755, 761, 88 L.Ed.2d 859 (1986) (quoting S.Rep. No. 989, 95th Cong., 2d Sess. 54 (1978); H.R.Rep. No. 595, 95th Cong., 1st Sess. 340 (1977)). The automatic stay extends to virtually all formal and informal actions against property of the bankruptcy estate. It is intended to `stop all collection efforts, all harassment, and all foreclosure actions.' S.Rep. No. 989, 95th Cong., 2d Sess. 54, reprinted in 1978 U.S. Code Cong. & Admin. News 5787, 5840. The automatic stay `is effective upon the date of the filing of the petition ... and formal service of process will not be required.' 2 Collier on Bankruptcy ¶362.03 (15th ed. 1988) (footnotes omitted). Actions taken in violation of the automatic stay generally are void, even if the creditor had no notice of the stay. See, e.g., In re Clark, 60 B.R. 13, 14, (Bankr. N.D. Ohio 1986) (Creditor `had not known of Debtor's filing at the time of repossession but ... it was, nonetheless, required to return the vehicle to Debtor.') In re Advent Corp., 24 B.R. 612 (Bankr. 1st Cir. 1982) (acts in violation of automatic stay are void regardless of lack of knowledge); Collier, supra, ¶362.03 (`In general, actions taken in violation of the stay will be void even where there was no actual notice of the existence of the stay.')" Cf. Easley v. Pettibone Michigan Corp., 990 F. 2d 905 (6th Cir. 1993).

Therefore, the Court finds and concludes that under Tennessee law upon the indenture trustee's execution of the deed (or similar memorandum required by the Tennessee statute of frauds) and payment of consideration, a non-judicial foreclosure sale becomes final and terminates a debtor's right to subsequently cure defaults under 11 U.S.C. §1322(b)(5) and the rationale set forth in In re Glenn, supra, provided such acts occur before the bankruptcy petition is commenced. This resolution and construction also will satisfy the Tennessee statue of frauds and concomitantly invoke pragmatic principles consistent with In re Glenn. Pre-bankruptcy registration or recordation of the indenture trustee's deed, however, is not a pre-condition to such termination of the debtor's rights provided that the indenture trustee's deed (or similar memorandum required by the Tennessee statute of frauds) has been executed and the consideration has passed prior to the commencement of the petition under the Bankruptcy Code.

CONGRESSIONAL PURPOSE AND POLICY

The foregoing result additionally is consistent with the Congressional purpose and policy underlying the bankruptcy laws.

PURPOSE

In enacting chapter 13 of the Bankruptcy Code, Congress was especially concerned with individuals who are able to keep up with their obligations in normal times, but do not prepare for emergencies or unexpected events such as a serious illness in a family or a job-layoff. The purpose of chapter 13 is to enable financially distressed individual debtors, under court supervision and protection, to develop and carry out a repayment plan under which creditors are paid over an extended period of time. See H.R. Rep. No. 595, 95th Cong., 2d Sess. 118 (1977), reprinted in 1978 U. S. Code Cong. & Admin. News 5963, 6079. Moreover, In re Taylor, 95 B.R. 48 (Bankr. N.D. Miss. 1988), the Court stated at p. 51 that "one of the primary purposes of chapter 13 rehabilitation is to save the homesteads" citing In re Young, 22 B.R. 620, 622 (Bankr. N.D. Ill. 1982).

POLICY

The policy that underlies chapter 13 is to encourage individual debtors to pay their debts instead of merely seeking a chapter 7 discharge. See H.R. Rep. No. 595, 95th Cong., 2d Sess. 118 (1977), reprinted in 1978 U.S. Code Cong. & Admin. News 5963, 6079.

In In re Taylor, 95 B.R. at pp. 50-51 the Court made the following observations.

> "It is in the best interest of debtors to allow a debtor to retain his home. `It is a significant motivating factor for the debtor to attempt to pay off his debts through Chapter 13 rather than discharge them through Chapter 7. The debtors maintain their self respect, the unsecured creditors receive a high payoff, and the government benefits from a more stable tax base.' In re Gwinn, 34 B.R. 936 [(Bankr. Ohio 1983)]."

In conclusion, it is observed that by virtue of 11 U.S.C. §§506(b), 1322(b)(2) and 1325(a)(5), SFI will receive the full economic benefit of its contractual bargain including ongoing monthly contractual payments and reimbursement of all its reasonable foreclosure fees and expenses.[1]

Debtors' counsel shall prepare an appropriate bare Order consistent with the foregoing and the Court's Fed. R. Bankr. P. 7052 oral findings of fact and conclusions of law made at a bench ruling in open Court on March 24, 1994.

BY THE COURT

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DAVID S. KENNEDY
CHIEF UNITED STATES BANKRUPTCY JUDGE

DATE: March 24, 1994

[1] It is also parenthetically observed that on December 7, 1993, oral arguments were made before the Supreme Court in the Ninth Circuit case of In re BFP, 974 F.2d 1144 (9th Cir. 1992), which held that the price received at a non-collusive, regularly-conducted foreclosure sale irrebuttably establishes "reasonably equivalent value," for purposes of 11 U.S.C. §548, which allows a bankruptcy trustee to avoid fraudulent transfers of a debtor's interest in property. BFP v. RTC, as Receiver of Imperial Sav. & Loan Ass'n (S.Ct.), No. 92-1370, May 24, 1993. See also In re Winshall Settlor's Trust, 758 F.2d 1136, 1139 (6th Cir. 1985); contra, Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201 (5th Cir. 1980) (holding that so long as the debtor received at least 70% of fair market value, the foreclosure sale cannot be avoided under section 548(a)(2)(A); cf. In re Bundles, 856 F.2d 815 (7th Cir. 1988) (opting for a middle ground approach).

11 U.S.C. §546(a) provides that the bankruptcy trustee has two years after the appointment date to commence an action under section 548 seeking, e.g., to avoid a foreclosure.

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