IT IS ORDERED as set forth below:

Date: November 25, 2009

W. H. Drake
U.S. Bankruptcy Court Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
NEWNAN DIVISION

IN THE MATTER OF:	:	**CASE NUMBER**
	:	
DERMOT W. HUGH,	:	
	:	09-10164-WHD
	:	
Debtor.	:	
	:	IN PROCEEDINGS UNDER
	:	CHAPTER 13 OF THE
	:	BANKRUPTCY CODE

O R D E R

Before the Court is a Motion to Convert the case of Dermot W. Hugh (hereinafter the "Debtor") from Chapter 13 to Chapter 7, filed by Adam M. Goodman (hereinafter the "Trustee"). The Trustee seeks to convert this case to Chapter 7 because he believes that a Chapter 7 trustee could avoid the first priority security interest on the Debtor's real property, thereby freeing up significant funds for payment to the Debtor's unsecured creditors. This

matter is a core proceeding over which the Court has subject matter jurisdiction. 28 U.S.C. § 157(b)(2)(A); § 1334.

FINDINGS OF FACT AND PROCEDURAL HISTORY

The Debtor owns real property in Jonesboro, Georgia (hereinafter the "Property"). The Property is currently valued at $185,000. To finance this purchase, the Debtor simultaneously executed two notes in the amounts of $149,920 (hereinafter the "First Promissory Note") and $37,480 (hereinafter the "Second Promissory Note"), respectively, to Bayrock Mortgage Corporation (hereinafter "Bayrock"). In conjunction with these notes, the Debtor also executed two security deeds (hereinafter the "First Security Deed" and the "Second Security Deed," respectively) in favor of Bayrock. The warranty deed to the Property and the Second Security Deed were recorded with the Fayette County Clerk of Superior Court on April 24, 2007. The First Security Deed was not recorded until March 30, 2009, over two months after the Debtor's bankruptcy petition was filed.

At some time after January 2007, Bayrock transferred its rights in the Property to Aurora Loan Services, LLC (hereinafter "Aurora"). The Debtor filed a voluntary petition under Chapter 13 of the Bankruptcy Code on January 19, 2009. On July 10, 2009, the Trustee filed the instant Motion, which the Debtor opposes. The Court held a hearing on August 6, 2009 and requested both parties file supplementary briefs supporting their respective positions, as well as a stipulation of the facts. The Trustee asserts that the Debtor's

case should be converted to Chapter 7 because the first priority security interest in the Property held by Aurora is avoidable, which would render the Debtor's proposed Chapter 13 plan incapable of satisfying the confirmation requirements.

CONCLUSIONS OF LAW

A motion to convert a case from Chapter 13 to Chapter 7 is governed by section 1307: "On request of a party in interest or the United States trustee and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title . . . for cause, including . . . (5) denial of confirmation of a plan under section 1325 of this title." Section 1325 places two requirements upon confirmation that, applied together, create a potential issue in this case. First, the Court may confirm a Chapter 13 plan only if it provides for at least as much payment to unsecured creditors as a Chapter 7 liquidation. *See* 11 U.S.C. § 1325(a)(4). Second, the Court may only confirm a Chapter 13 plan that is feasible given the debtor's current financial position. *See* 11 U.S.C. § 1325(a)(6).

In this case, the Debtor's plan proposes to pay $255 per month to the Trustee, which would provide no dividend to the unsecured creditors. The Trustee contends that unsecured creditors could recover a substantially higher amount through liquidation of the Debtor's estate in Chapter 7. Particularly, the Trustee contends that, since the First Security Deed against the Debtor's residence was not filed until after the Debtor's petition was filed, a Chapter 7 trustee could render the debt represented by the First Promissory Note unsecured

by avoiding Aurora's first priority security interest under sections 544(a)(3) and 549. If the Trustee is correct, conversion to Chapter 7 would allow a trustee to sell the residence, valued at $185,000, and disperse a large portion of the funds to unsecured creditors.[1] The critical question before the court then becomes whether a Chapter 7 trustee could avoid Aurora's first priority security interest, thereby providing a significantly larger source of funds for unsecured creditors than the Debtor's confirmed Chapter 13 plan.

A. *Section 544(a)(3)*

Under section 544 of the Bankruptcy Code, "[t]he trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any other creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by . . . a bona fide purchaser of real property . . . from the debtor . . . that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists." 11 U.S.C. 544(a)(3). Although the actual knowledge of the trustee or a creditor is not relevant, the statute does not permit a trustee to avoid a transfer or obligation if, under applicable state law, a hypothetical bona fide purchaser of real property would have had constructive notice or inquiry notice of the transfer or obligation. *See In re Hagendorfer*,

[1] Of course, it should be noted that Aurora would receive a significant portion of the funds brought by the sale of the home, as Aurora would have, by far, the largest unsecured claim against the Debtor's Chapter 7 estate.

803 F.2d 647 (11th Cir. 1986)*; In re Robertson*, 203 F.3d 855 (5th Cir. 2000); *see also In re Cotton*, 2004 WL 2983350, *4-5 (Bankr. N.D. Ga. Feb. 17, 2004) (Bonapfel, J.); *In re Henderson*, 284 B.R. 515 (Bankr. N.D. Ga. 2002) (Mullins, J.); *In re Sheetex, Inc.*, 1999 WL 739628 (Bankr. M.D. Ga. 1999) ("It follows that if circumstances would prevent any hypothetical purchaser from taking Debtor's property in good faith and without notice, then there exist no "shoes" of a hypothetical bona fide purchaser at the time of the commencement of the case for Trustee to step into."); *In re Georgia Granite Co., Inc.*, 86 B.R. 733 (Bankr. N.D. Ga. 1988) (Drake, J.) ("In each of the states involved herein, a purchaser is charged with constructive notice of matters contained within recorded deeds which lie in the chain of title for the property in question, and, furthermore, the purchaser may be charged with inquiry notice as to incomplete or inconsistent matters of record or references to outside documents which impose on the purchaser a duty to inquire further.").

The priority of interests in real property is a question of state law. *In re Hendrick*, 524 F.3d 1175, 1181 (11th Cir. 2008). Georgia is a "race-notice" state. Accordingly, a bona fide purchaser of real property may take an interest greater than that held by the holder of an unrecorded interest in real property, as long as the bona fide purchaser had no notice of the unrecorded interest. O.C.G.A. § 44-2-1; O.C.G.A. § 44-2-3. To that end, in Georgia, a purchaser of land is charged with constructive notice of the contents of a recorded instrument within its chain of title. *Virginia Highland Civic Assoc., Inc. v. Paces Properties, Inc.*, 250 Ga. App. 72, 74 (2001). Therefore, if, as of the petition date, a hypothetical bona fide

purchaser could have taken a greater interest in property than the holder of an unrecorded interest, a bankruptcy trustee may do so as well.

In this case, on the petition date, Aurora had not yet filed the First Security Deed. Accordingly, a hypothetical bona fide purchaser would not have had constructive notice of the existence of Aurora's first priority mortgage. Nonetheless, the Debtor asserts that a hypothetical bona fide purchaser would have been placed on inquiry notice of the existence of Aurora's first priority security interest.

As noted above, the proper recording of a security deed provides a purchaser of land with constructive notice of the contents of a recorded instrument within its chain of title. *Virginia Highland Civic Assoc., Inc. v. Paces Properties, Inc.*, 250 Ga. App. 72, 74 (2001); *Delijoo v. SunTrust Mortgage*, 284 Ga. 438, 439 (2008). A purchaser of real property is not only charged with notice of every fact shown by the records in the chain of title, but is also "presumed to know every other fact which the examination suggested." *Id.* As a result, "when information appears in the county records . . . that would excite a reasonable purchaser's attention regarding the existence of a lien . . . the purchaser has a duty to make a further inquiry." *Gallagher v. Buckhead Community Bank*, 2009 WL 2195932 at*3 (Ga. App. 2009); *see also* O.C.G.A. § 23-1-17. Any notice which is sufficient to create the duty to inquire further is also notice of "everything to which it is afterwards found that such inquiry might have led." *Gallagher,* 2009 WL 2195932 at *3. Thus, "once the duty to inquire arises, a purchaser's ignorance of a fact, such as a lien or other issue affecting the title to the

property, due to his or her negligence in failing to make the additional inquiry will be the equivalent of the purchaser's constructive knowledge of the fact." *Id*.

The Debtor submits, and the Court agrees, that the Second Security Deed, properly recorded over two years before the commencement of the case, provides constructive notice to the world of its contents. The Second Security Deed contains multiple references to its status as a secondary lien. On each page of the Second Security Deed, the parties included a header and a footer which both labeled the document a "Secondary Lien". While the Trustee concedes that the labeling upon the Second Security Deed signaled that a primary lien existed at one time, he argues that an investigation into the public records would have yielded no information regarding another lien on the Debtor's property, and thus no constructive notice would exist for section 544(a)(3) purposes. The Trustee's position unduly limits the breadth of inquiry notice charged to a purchaser of property when information within the chain of title triggers further inquiry. Georgia courts have not limited inquiry notice solely to information found in the public records; rather, Georgia courts have explicitly stated that, once the duty to inquire is triggered, a hypothetical purchaser has notice of *everything* an inquiry might have uncovered. *See Delijoo*, 248 Ga. at 239; *see also Gallagher* 2009 WL 2192532 at *3.

In this case, a prospective purchaser reviewing the public record would have found a document labeled clearly as a second lien, and upon further review, would have located no first priority lien or cancellation of any first priority lien. Faced with the combination of the

Second Security Deed and the lack of any recording of a first mortgage or its satisfaction, a prospective purchaser would have inquired of the owner of the Property, and possibly the holder of the second mortgage, as to whether a first priority security interest ever existed and, if so, whether it had been satisfied.

Thus, a Chapter 7 trustee would be unable to avail himself of section 544(a)(3) to avoid Aurora's first priority security interest because, the trustee, slipping into the shoes of a hypothetical purchaser, would have had notice of that interest through the language in the Second Security Deed.

B. 11 U.S.C. §§ 362 and 549

Alternatively, the Trustee argues he can avoid Aurora's first priority security interest through the use of either section 362 or section 549. Section 362 imposes a stay, applicable to all entities, of "any act to create, perfect or enforce any lien against property of the estate." 11 U.S.C. § 362(a)(4). The Eleventh Circuit has ruled that transactions in violation of the automatic stay are void unless validated by an annulment of the stay pursuant to section 362(d). *Borg-Warner Acceptance Corp. v. Hall*, 685 F.2d 1306 (11th Cir. 1982). In addition, section 549 allows a Trustee to avoid an unauthorized transfer of an interest in property of the estate "that occurs after the commencement of the case." 11 U.S.C. § 549 (a)(1).

In this case, the Trustee correctly states that a trustee can avoid the postpetition filing

of the security deed if it is not an authorized transfer of an interest in property of the estate. Further, the filing of a security deed postpetition that encumbers property of the estate would be void under section 362.

Nonetheless, Aurora's failed attempts to perfect its first priority security interest in the Property after the petition date does not render its claim unsecured. To render Aurora's claim unsecured, the Trustee must show that, as of the petition date, a hypothetical bona fide purchaser could have taken a greater interest in the Property than Aurora's first priority security interest. As discussed above, a hypothetical bona fide purchaser could not have done so due to the inquiry notice provided by the Second Security Deed, which was properly filed more than two years before the filing of the petition.

The Court agrees with the Trustee that, ordinarily, Aurora's postpetition attempts to perfect its first priority security interest in the Property would violate the automatic stay and would be avoidable under section 549. That being said, as of the petition date, a hypothetical bona fide purchaser could not have obtained an interest in the Property ahead of Aurora's first priority security interest due to constructive and inquiry notice charged to such a purchaser under Georgia law. If, as of the filing date, no notice of Aurora's first priority security interest had existed, a Chapter 7 trustee would have had the power to avoid the security interest and Aurora's postpetition attempts to provide such notice would not have altered that result. As this is not the case, Aurora's failed attempt to provide notice of that interest after the filing of the case is simply irrelevant.

The Court's conclusion on this issue is supported by *In re Ibach*, 399 B.R. 61 (Bankr. D. Minn. 2008), which was cited by the Trustee as authority contrary to his position. In *Ibach*, the lender's originally filed mortgage contained a faulty legal description, and the lender attempted to correct this error by re-recording the mortgage postpetition. When the trustee sued the lender to avoid the mortgage under section 544(a)(3), the court ruled against the trustee, finding that the mortgage provided notice to a hypothetical bona fide purchaser of the lender's interest. *Id*. at 70-71. As to the trustee's attempts to avoid the postpetition transfer, which the trustee asserted occurred when the lender re-recorded the mortgage, the court found that, since the trustee failed to invalidate the lender's mortgage, the postpetition attempt to better the lender's position had no effect on property of the estate. *See id*. Accordingly, the trustee lacked the statutory predicate -- proof of an unauthorized transfer of an interest in estate property -- necessary to avoid the postpetition transfer. See id. at 70-71 ("Had the Trustee [prevailed under section 544(a)(3)], relief under the counts under §§ 549 and 362 would have followed in logical sequence: if the value in the land . . . had not been attached under the first mortgage instrument as of the date of the Debtors' bankruptcy filing, the post-petition attachment of a lien under the second mortgage instrument to secure a like amount of pre-petition debt, having never been authorized by the bankruptcy court, was both an act affecting property of the bankruptcy estate that violated the automatic stay, and a post-petition transfer to NetBank that would have been avoidable at the Trustee's instance. However, that value was already encumbered by [the lender's] lien in a fashion enforceable

against the estate, and it was not available for administration in bankruptcy.").

As in the *Ibach* case, a Chapter 7 trustee's attempt to avoid Aurora's first priority security interest under section 544(a)(3) would fail. Likewise, neither section 549 nor section 362 would impact the secured status of Aurora's claim. The contrary authority cited by the Trustee does not persuade the Court that the Trustee should prevail.

First, the Trustee cites *In re Potter*, 2008 WL 619410 (Bankr. E.D. Ky. Mar. 5, 2009), for the proposition that recording a scrivener's affidavit postpetition is void as a violation of the automatic stay and avoidable under section 549 to the extent that it constitutes a transfer of a property interest. Again, the Court has no qualms about the accuracy of this proposition. However, the effect of that ruling has no bearing on this case. In *Potter*, the court independently held that the mortgage at issue was avoidable under section 544(a)(3). *See id*. at *2. The relevancy of the postpetition attempt to "fix" the mortgage, therefore, comes about because the court found the mortgage to be "broken." In this case, Aurora's security interest is not defective and, therefore, the failed attempt by Aurora to correct the record is irrelevant.

Second, the Trustee cites *In re Prescott*, 402 B.R. 494 (Bankr. D.N.H. 2009) for the proposition that, even when the trustee fails to show that a mortgage is defective, a court can avoid a postpetition attempt to correct the mortgage. While this again is a true proposition, the significance of the proposition to the resolution of this case is less clear. In *Prescott*, the lender, which held a mortgage on real property, obtained relief from the automatic stay to foreclose its mortgage, but later realized that the legal description did not adequately describe

the entire property. The lender subsequently brought a suit in state court to reform the mortgage. Upon learning of the state court suit, the Chapter 7 trustee filed a complaint under section 544(a)(2) to avoid the lender's mortgage over that portion of the property that was not accurately defined in the mortgage's legal description. The trustee also asserted that the lender's postpetition reformation of the mortgage and its obtaining of an "attachment" against the property were void under section 549. On a motion for summary judgment, the court denied relief to the trustee on the section 544(a)(2) count, finding that the legal description properly described the entire property and, even if it had not, a hypothetical lien creditor would have had constructive notice of the lender's interest in the entire tract of land. *See id*. at 500. The court went further to hold that the lender's postpetition actions were outside the scope of the relief from the automatic stay previously granted by the court. Accordingly, the court agreed with the trustee that the actions taken to reform the mortgage and to obtain an attachment were void under section 549.

Nonetheless, the effect of that ruling does not appear to be an invalidation of the lender's originally perfected mortgage over the entire tract of land. The court did not state that the lender's claim became unsecured. To the contrary, the court ordered that the "Defendant [the lender] is entitled to the net proceeds of the sale of the Debtors' property in partial satisfaction of its claim." *Id*. at 501. If the court determined that the lender's mortgage was rendered unenforceable due to the lender's postpetition attempts to reform a mortgage that the court had just determined was not even defective, one would not expect

the court to authorize the lender's claim to be paid from the sale of the land without awaiting a normal distribution of estate assets by the trustee in accordance with section 726. As in the *Prescott* case, the Court could find here that the postpetition attempt to correct Aurora's security interest was void and had no effect; yet, because the security interest needed no correction, the avoidance of such acts would have no effect on Aurora's status as a secured creditor.

CONCLUSION

As a Chapter 7 trustee could not avoid Aurora's first priority security interest in the Property, no justification exists under sections 1307 and 1325 to convert this case to a Chapter 7. As such, the Trustee's motion to convert the case from a Chapter 13 to a Chapter 7 is **DENIED**.

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