

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF KENTUCKY
LEXINGTON DIVISION

IN RE:

TIMOTHY L. SCOTT
JEANNE F. SCOTT

CASE NO. 13-51169

DEBTORS

SUPPLEMENTAL MEMORANDUM OPINION

This matter is before the Court on Debtors' Motion to Authorize Sale of Property Free and Clear of Liens, to Assume Listing Contract, to Shorten Notice of Hearing, and to Disburse Sale Proceeds ("Motion") [Doc. 40]. The Court previously entered an Order denying the Motion [Doc. 59]. This Supplemental Memorandum Opinion is entered to set forth the Court's analysis in denying the Motion.

The Debtors sought approval to sell the real property located at 1631 Alexandria Drive, Lexington, Kentucky (the "Property"), approval of a listing contract, and authorization to disburse the net sale proceeds to Kentucky Bank (the "Bank"). The Bank filed a Response [Doc. 48] objecting (a) to the sale of the Property because the proposed selling price was not sufficient to pay the Bank's first mortgage note in full; and (b) to the listing contract's commission provisions because the broker is one of the Debtors. A hearing was held on August 1, 2013. Following post-hearing briefing, the Court took the matter under submission. For the reasons set forth below, the Motion was denied.

Factual/Procedural Background

On November 12, 2003, the Debtors borrowed \$630,000.00 from the Bank to purchase the Property. In connection with the loan, the Debtors executed and delivered a Promissory Note and Real Estate Mortgage to the Bank. The mortgage encumbered both the Property and additional real property located at 1573 Alexandria Drive, Lexington, Kentucky (the "Additional

Property”).

The Debtors filed a chapter 13 petition on May 3, 2013 listing the Bank on Schedule D as having an undersecured claim. The Bank filed a secured proof of claim in the amount of \$535,821.61 listing the Property and Additional Property as collateral for the loan [Proof of Claim 3-1]. There is no confirmed plan in this case.

On June 17, 2013, the Additional Property was sold to a third-party pursuant to an agreed order signed by both the Debtors and the Bank for the price of \$225,000.00 [Doc. 34].

On July 23, 2013, the Debtors filed the Motion seeking to sell the Property via private sale to a third-party for \$235,000.00 stating that “upon information and belief, Kentucky Bank has no objection to consummation of the sale and payment of a fixed \$5,000.00 real estate commission to Modern Real Estate.” However, the Bank did object to the sale arguing that the property cannot be sold over its objection because the Debtors failed to meet the requirements of § 363(f). Debtors contend in response that the proposed sale price reflects the fair market value of the Property and the Debtors have met the requirements of § 363(f)(5).

Analysis

This Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334(b), and this is a core proceeding under 28 U.S.C. § 157(b)(2)(N). Venue is proper pursuant to 28 U.S.C. § 1409.

Section 363(f) provides:

The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if –

- (1) the applicable nonbankruptcy law permits sale of such property free and clear of such interest;
- (2) such entity consents;
- (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
- (4) such interest is in bona fide dispute; or
- (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

11 U.S.C. § 363(f). Here, the Debtors contend the requirements of subsection (5) are met by

Kentucky foreclosure law.

The Bank cites Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC), 391 B.R. 25 (B.A.P. 9th Cir. 2008) as illustrative of the narrow applicability of § 363(f)(5). The Bank argues that the terms of that section do not include a judicial foreclosure action which, it asserts, is not a proceeding in which the Bank could be compelled to accept a money satisfaction of its lien. To fully understand the Bank's position, it is necessary to cite at length from the PW, LLC opinion discussing § 363(f)(5):

We parse this paragraph [§ 363(f)(5)] to contain at least three elements: that (1) a proceeding exists or could be brought, in which (2) the nondebtor could be compelled to accept a money satisfaction of (3) its interest.

Courts are divided over the interpretation of each of these elements. We analyze these components in reverse order. We start with an analysis of what Congress meant by an "interest," then move to the proper construction of a money satisfaction, and conclude with an examination of appropriate legal and equitable proceedings.

a. Lien as Interest

Clear Channel's primary contention is that the term "interest" must be read narrowly to exclude liens such as the one it holds. So read, § 363(f)(5) would be inapplicable, as a matter of law, to authorize the sale free and clear of Clear Channel's lien. Clear Channel asserts that to do otherwise renders the other subsections under § 363(f) mere surplusage.

We reject Clear Channel's argument. We believe that Congress intended "interest" to have an expansive scope,

...

[T]hough the Code does not define "interest," it does define "lien." . . . [L]ien "means charge against or *interest* in property." The definition of lien provides another inference consistent with the interpretation that a lien is but one type of interest.

...

b. Compelling Money Satisfaction

...

The bankruptcy court found paragraph (f)(5) applicable whenever a claim or interest can be paid with money. We do not think that § 363(f)(5) is so simply analyzed. Although it is tautological that liens securing payment obligations can be satisfied by paying the money owed, it does not necessarily follow that such liens can be satisfied by paying *any* sum, however large or small. We assume that paragraph (5) refers to a legal and equitable proceeding in which the nondebtor could be compelled to take *less* than the value of the claim secured by the interest.

...

Although this view leads to a relatively small role for paragraph (5), we are not effectively writing it out of the Code. Paragraph (5) remains one of five different justifications for selling free and clear of interests, and its scope need not be expansive or all-encompassing. So long as its breadth complements the other four paragraphs consistent with congressional intent, without overlap, our narrow view is justified.

Examples can be formulated that demonstrate this complementary aspect of a narrow view of paragraph (5). One might be a buy-out arrangement among partners, in which the controlling partnership agreement provides for a valuation procedure that yields something less than market value of the interest being bought out. . . . Yet another might be satisfaction of obligations related to a conveyance of real estate that normally would be specifically performed but for which the parties have agreed to a damage remedy.

. . .

c. Legal or Equitable Proceeding

Paragraph (5) requires that there be, or that there be a possibility of, some proceeding, either at law or at equity, in which the nondebtor could be forced to accept money in satisfaction of its interest.

PW, LLC, 391 B.R. at 41-45 (citations omitted).

This Court finds persuasive and agrees with the construction of § 365(f)(5) quoted above. Thus, while the Bank's lien is an "interest", the issue is whether there exists a legal or equitable proceeding in which the Bank could be compelled to take less than the amount of its claim secured by its lien. The Debtors assert that a Kentucky judicial foreclosure proceeding meets that requirement.

In support, the Debtors refer the Court to two Kentucky cases: U.S. v. Wood, 658 F. Supp. 1561 (W.D. Ky. 1987); and Makkiben v. Arndt, 10 Ky. L. Rptr. 847, 10 S.W. 642 (Ky. Ct. App. 1889). The crux of Debtors' argument is that in Kentucky, a mortgage lien may be extinguished through a judicial sale and the resulting payment of money; thus § 363(f)(5) applies. The Debtors further argue that the Court has flexibility in interpreting the meaning of "compelled" in § 363(f)(5), citing In re Signature Developments, Inc., 348 B.R. 758, 764 (Bankr. E.D. Mich. 2006). Lastly, the Debtors argue that a receiver may sell property free and clear of liens which implies that they can use § 363(f)(5). The Wood and Makkiben cases stand for the

unremarkable proposition that a judicial sale extinguishes liens on the property sold. Neither case supports an argument that a creditor in a foreclosure action can be compelled to accept less than full payment therein.

Judicial foreclosure actions are suits by creditors (not debtors) to convert liens into a money satisfaction. Debtors' reliance on Kentucky foreclosure cases in which junior liens were not paid in full is misplaced. Kentucky foreclosure law provides numerous protections for creditors to insure they are not compelled to take less than their claim. For example, a foreclosing creditor must name as parties to the foreclosure action all other lienholders on the subject property to insure all such liens have the opportunity to be satisfied by sale. KY. REV. STAT. § 426.006. A lienholder may bid at a foreclosure sale to avoid being compelled to accept less than its lien. See generally, U.S. National Bank Association v. American General Home Equity, Inc., 387 S.W. 3d 345, 348 (Ky. Ct. App. 2012). Moreover, a junior lienholder may only receive proceeds of sale after prior liens have been paid in full. KY. REV. STAT. § 426.280. No matter how flexible the word "compelled" is, the Bank could not be compelled to sell the property for less than what was owed. Similarly, if a receiver was to sell the Property, the Bank would have the same protections. Finally, the value of the Property has no relevance to the § 363(f) analysis. In re Walling, Bankr. E.D. Ky. 10-51619 [Doc. 59].

Based on the foregoing, the Debtor's motion to sell the Bank's collateral for less than the amount due to the Bank over the Bank's objection was denied.

~~~~~  
***The affixing of this Court's electronic seal below is proof this document has been signed by the Judge and electronically entered by the Clerk in the official record of this case.***



**Signed By:**  
**Joe Lee**  
**Bankruptcy Judge**  
**Dated: Wednesday, August 21, 2013**  
**(tnw)**