

In the matter of:)	
)	Chapter 11 Case
RESORT INNS, INC.)	
d/b/a Ocean Plaza Beach Resort)	Number <u>04-41721</u>
)	
<i>Debtor</i>)	

**ORDER ON BRANCH BANKING & TRUST COMPANY’S
MOTION FOR POST-PETITION LIEN IN DEBTOR’S
RENTS, PROFITS AND PROCEEDS**

Debtor filed for Chapter 11 protection on June 1, 2004. On July 29, 2004, Branch Banking & Trust Company (“BB&T”) filed a Motion for Post-Petition Lien on Debtor’s Rents, Profits and Proceeds. A hearing was held on this Motion on August 13, 2004. This Court has jurisdiction over this core proceeding pursuant to 28 U.S.C. § 157(b)(2)(K).

FACTS

The facts in this matter are undisputed. Debtor operates a hotel on Tybee Island, Georgia. On March 29, 1999, Debtor executed a promissory note in favor of First Liberty Bank, BB&T’s predecessor in interest, for the amount of \$8,400,000.00. Debtor conveyed to BB&T a first-priority security interest in the real property, the hotel, the personal property in the hotel, the Debtor’s accounts receivable, and all rents, issues, revenues and profits from the hotel, as well as other collateral and the proceeds thereof.

BB&T’s security interest in Debtor’s property is evidenced by the Deed to Secure Debt and Security Agreement (“Security Agreement”) and the Collateral Assignment of Rents, Profits and Various Permits (“Assignment of Rents”) (Exhibit 1), the Modification of the Deed to Secure

Debt (Exhibit 2), and the UCC-1 Financing Statement (Exhibit 3). BB&T recorded each of these documents in the real property records for Chatham County, Georgia. After Debtor's failure to pay the balance of the note on the date it matured, Aron Weiner of Weiner, Shearhouse, Weitz, Greenberg & Shawe, LLP, conducted a title search and prepared a certificate of title confirming the validity and first-priority position of BB&T's lien in the Debtor's real and personal property including the rents, profits and proceeds.

Of particular importance in this matter is the Assignment of Rents which specifically provides:

NOW, THEREFORE, for and in consideration of the above recitals, and the loan being made to Borrower by Lender in the total amount of \$8,400,000.00, Borrower hereby sells, transfers and assigns to Lender, its successors and assigns, all of the right, title and interest of Borrower in and to the rents, issues, profits, revenues, royalties, rights and benefits . . . for the following described properties . . .

It is understood and agreed that Lender shall not exercise any of its rights under this Assignment unless and until there has been a default in the payment of the indebtedness owed by Borrower to Lender for the Loan being made this date in the total amount of \$8,400,000.00.

Borrower hereby authorizes and empowers Lender, its successors and assigns, to collect the said rents, issues, profits, revenues, royalties, rights and benefits, as they shall become due, and does hereby direct each and all of the lessees/tenants of the aforesaid premises to pay such rents as may now be due or shall hereafter become due to Lender, its successors and assigns, upon demand for payment thereof by Lender, its successors or assigns. It being

understood and agreed, however, that until such demand is made, Borrower is authorized to collect, or continue collecting, said rents, issues, profits, revenues, royalties, rights and benefits.

The Modification of the Deed to Secure Debt provided the Debtor with five days written notice of a violation of the terms of the loan and an opportunity to cure before the violation would be deemed to constitute a default.

On May 27, 2004, John A. Thomson, Jr., attorney for BB&T, mailed a letter to Debtor notifying it that it had five days from receipt to pay the entire unpaid balance of principal and interest (Exhibit 5). This letter constituted BB&T's notice of default, and Debtor received it on May 28, 2004. On June 1, 2004, prior to the expiration of the five day period, Debtor filed for Chapter 11 protection.

CONCLUSIONS

Section 552 of the Bankruptcy Code governs the post-petition effect of a security interest. Generally, property acquired after the filing of the case will not be subject to a lien from a security agreement that existed prior to the filing. 11 U.S.C. § 552(a). However, Section 552(b) provides an exception to the general rule. It was amended by the Bankruptcy Reform Act of 1994 to include Section 552(b)(2) which provides in relevant part:

(b)(2) Except as provided in sections 363, 506(c), 522, 544, 545, 547, and 548 of this title, and notwithstanding section 546(b) of this title, if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to amounts paid as rents of such property or the fees, charges, accounts, or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties, then such security interest extends to such

rents and such fees, charges, accounts, or other payments acquired by the estate after the commencement of the case to the extent provided in such security agreement, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.

This amendment was intended to “clarif[y] the bankruptcy treatment of hotel revenues which have been used to secure loans to hotels and other lodging accommodations.” H.R. Rep. No. 103-835, at 49 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3358.

BB&T asserts that it is entitled to a post-petition lien in the rents, profits and proceeds from the operation of the hotel pursuant to 11 U.S.C. § 552(b)(2) because it entered into the security agreement before the commencement of the case and the agreement extended to rents, profits and proceeds acquired before the commencement of the case. Debtor argues that BB&T is not entitled to a post-petition lien on the rents, profits and proceeds from the operation of the hotel for the following reasons: (1) there was no pre-petition default on the loan giving rise to enforcement; (2) BB&T did not take any action to enforce its rights under either the Assignment of Rents or state law; and (3) recognition of a post-petition lien would violate the longstanding bankruptcy policy of preventing a windfall to the secured creditor.

1. Default

Debtor asserts that there was no pre-petition default on the loan; therefore, BB&T had no pre-petition right to enforce the Assignment of Rents. Debtor argues if BB&T did not have a right to enforce the Assignment of Rents, then it is not entitled to a post-petition lien in the rents.

However, as the Court holds in Part 2, pre-petition enforcement of the Assignment

of Rents is not essential to the existence of a post-petition lien. Thus, the fact that there was no pre-petition default on the security agreement does not prevent the recognition of a lien in this case.

2. *Enforcement*

Debtor further contends that even if a default did occur, BB&T failed to take any affirmative enforcement action under the terms of the contract or those required by state law.

Debtor argues that although BB&T's lien was validly recorded, it had not been enforced pre-petition; and the lack of enforcement precludes the attachment of any post-petition lien.

a. Enforcement under the terms of the contract

Debtor argues BB&T failed to make a demand for the payment of rents as required under the Assignment of Rents. Debtor asserts that no lien exists because a lien only exists to the "extent provided in such security agreement," and the Security Agreement requires BB&T to take specific enforcement actions that were not taken because the five day cure period after BB&T's notice of default had not run.

Both BB&T and Debtor recognize that the distinction between perfection and enforcement is determinative of this matter. In support, both parties rely on this Court's ruling in In re May, 169 B.R. 462 (Bankr. S.D. Ga. 1994)(Davis, J.). Debtor asserts that the May decision stands for the proposition that unless an enforcement action is taken after a default, the security interest in the rents is an inchoate right which does not give rise to a post-petition lien. BB&T asserts that the May decision supports the recognition of a post-petition lien on the rents, profits and proceeds as long as the Assignment of Rents and Deed to Secure Debt were duly perfected.

In May, the debtors executed a Security Deed and an Assignment of Rents in favor of California Federal Bank, and both documents were properly recorded. Upon debtors' failure to pay the note, California Federal sent a notice of default as required under the agreement, but it did not take any further action required by state law. California Federal asserted it had an absolute right to sole possession of the rents or a classification of rents as cash collateral, and the debtors countered that its failure to take affirmative action to collect the rents made California Federal's interest invalid.

An interest in rents is an inchoate right prior to enforcement, but the underlying lien is valid regardless of enforcement. In Vienna Park Properties, the Second Circuit noted that "the enforceability of an interest is an issue distinct from the issue whether a security interest exists under § 552(b). The failure of a secured party to perform enforcement procedures prior to bankruptcy merely renders an interest inchoate, not nullified." Vienna Park Properties v. United Postal Sav. Ass'n (In re Vienna Park Properties), 976 F.2d 106, 112 (2nd Cir. 1992); *see also* In re White Plains Dev. Corp., 136 B.R. 93, 95 (Bankr. S.D.N.Y. 1992); In re KNM Roswell L.P., 126 B.R. 548, 556 (Bankr. N.D. Ill. 1991).

Because California Federal properly recorded the Security Deed and Assignment of Rents, I held that it had a valid, perfected interest in the post-petition rents and the rents constituted cash collateral. In re May, 169 B.R. at 465-66. The interest was perfected when it was recorded, thus, "the rents derived from [the duplex] were 'cash collateral' under section 363(a) from the date Debtors filed their Chapter 11 petition." Id. at 467. I also held that California Federal had taken all the steps

necessary to enforce the assignment and it had a choate interest. In re May, 169 B.R. at 470.¹

BB&T recorded its Deed to Secure Debt and the Collateral Assignment of Rents in 1999. Applying May to the case at bar, it is evident that the lien in the pre-petition rents was valid from the time of recording. It is undisputed that BB&T did not enforce the Assignment of Rents prior to the filing and is not entitled to do so absent a Court order, but regardless of enforcement, the lien in post-petition rents was valid from the time of the bankruptcy filing.

b. Enforcement under state law

In addition to BB&T's failure to make a demand for the rents as required by the Assignment of Rents, Debtor argues that BB&T also failed to take the steps required under Georgia law to enforce the Assignment of Rents, and for this reason, BB&T is not entitled to a lien in the rents. Debtor points to language in In re Polo Club Apartments that states, "additional affirmative action by the grantee is required before the interest conveyed by the rent assignment can become absolute." In re Polo Club Apartments Associates, 150 B.R. 840, 850 (Bankr. N.D. Ga. 1993).

After the 1994 addition of Subsection 552(b)(2), the argument advanced in In re Polo Club and other cases cited by the Debtor is no longer persuasive. The legislative history of Section 552(b)(2) suggests it was "intended to obviate the need to comply with additional

¹Debtor apparently reads this holding in such a way that "perfected" means the same thing as "choate." To the contrary, the lien in May was perfected, thus it satisfied Section 552(b). Whether it was choate or inchoate depended on whether it had been enforced. If the Assignment was enforced, then it was choate and California Federal had the right to immediate possession of the rents subject to the debtor's equitable interest in the rents. If the Assignment was not enforced, an immediate possessory interest would not exist, but the lien still would. In this case, BB&T, unlike California Federal, is not attempting to obtain immediate possession of the rents. It merely seeks recognition that the lien exists. For that reason, the portions of the May case regarding enforcement are inapplicable. This same distinction applies to Debtor's argument that the failure to take the state law steps necessary to enforce the Assignment of Rents precludes the recognition of a lien in the post-petition rents.

requirements imposed by state law.” In re Wrecclesham Grange, Inc., 221 B.R. 978, 981 (Bankr. M.D. Fla. 1997). Prior to the amendment, Section 552(b) specifically stated that the creditor’s rights were dependent on “applicable nonbankruptcy law.” Accordingly, the courts would examine state law to determine if a pre-petition security interest extended to post-petition rental income. *See, e.g.*, First Nat’l Bank of Bar Harbor v. United States (In re Dorsey), 155 B.R. 263 (Bankr. D. Me. 1993). However, Subsection (b)(2) omitted any reference to applicable nonbankruptcy law. Thus, if a creditor holds a valid pre-petition security agreement which extends to rents, it will also extend to post-petition rents and constitute cash collateral regardless of any unsatisfied state perfection requirements. In re Wrecclesham Grange, Inc., 211 B.R. at 981 (citing In re Barkley 3A Investors, Ltd., 175 B.R. 755, 758 (Bankr. D. Kan. 1994)). *See also* County of Orange v. Merrill Lynch & Co. (In re County of Orange), 191 B.R. 1005, 1019 (Bankr. C.D. Cal. 1996); Homestead Partners, Ltd. v. Condor One, Inc. (In re Homestead Partners, Ltd.), 200 B.R. 274, 279 (Bankr. N.D. Ga. 1996).

Accordingly, this Court finds that BB&T’s failure to take the necessary steps under Georgia law to enforce its rights under the Assignment of Rents does not preclude it from having a post-petition lien on the rents.

3. *Windfall*

Debtor argues if BB&T receives a post-petition lien, it will be a violation of the longstanding bankruptcy policy preventing a creditor from being placed in a better position on account of the bankruptcy filing. In support, Debtor relies on Butner v. United States, 440 U.S. 48, 99 S.Ct. 914, 59 L.Ed.2d. 136 (1979), which states:

[p]roperty 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 prevent a party from receiving ‘a windfall merely by reason of the happenstance of bankruptcy.’ *Id.* at 55.

In Butner, the Court refused to approve the imposition of a post-petition lien on rents by operation of federal law when state law created no such automatic lien and required affirmative action before the right was recognized. *Id.* at 56. At the time this case was argued before the Court, the older version of 11 U.S.C. § 552 had been in effect for three weeks, and although it was not addressed in the opinion, the Court still looked to state law, as the pre-1994 Code provided, to determine the extent of these liens. However, all the rules changed in 1994 when Congress adopted the special subsection for hotel revenues that makes no reference to state law. As a result of this post-Butner statutory change, there is no “windfall” in recognizing a post-petition lien in the rents, profits and proceeds because Congress enacted a federal law defining the mortgagee’s interest in the rents and granted a post-petition lien in them regardless of state law. *See In re White Plains Dev. Corp.*, 137 B.R. 139, 142 (Bankr. S.D.N.Y. 1992)(noting that although Butner states that a mortgagee should not receive a windfall, the Bankruptcy Code enlarged the rights of secured creditors with respect to cash collateral). If a windfall does exist, it is best remedied by Congress.

Conclusion

A post-petition lien under Section 552(b)(2) is subject to limitation based on the equities of the case. One of the factors considered when determining the extent of the lien is the existence of an equity cushion in the collateral. *See Wilke Truck Serv. Inc. v. Wiegmann (In re*

Wiegmann), 95 B.R. 90, 94 (Bankr. S.D. Ill. 1989). Debtor asserts that there is a substantial equity cushion in the property and that the post-petition lien should be limited to the extent of that equity. This argument is premature as the Court has not yet held a hearing valuing the collateral. Any limitation of the lien on post-petition rents, profits and proceeds may merit further consideration after a valuation hearing; however, at this time, the post-petition lien is deemed valid and perfected. Debtor is ordered to continue to operate subject to the Third Interim Order Granting Debtor's Motion for Authority to Use Cash Collateral until further order.

ORDER

Pursuant to the foregoing, IT IS THE ORDER OF THIS COURT that BB&T's Motion for Post-Petition Lien in Debtor's Rents, Profits and Proceeds is GRANTED.

Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia

This 30th day of August, 2004.