

## Developer Files Bankruptcy: What to do now and "trip wires" to avoid

by Melissa Davis and Rika Kido, Associates, Shulman Hodges & Bastian LLP

The developer you are working for, or worked with in the past, filed bankruptcy but you have not been paid in full for your services. While you had the foresight to record a mechanics' lien secured by the developer's real property, you have no idea what to do now and may not know the "trip wires" to avoid in trying to collect. This article provides a general overview of the rights a lienholder has to obtain relief from the bankruptcy automatic stay, certain "trip wires" that may occur in connection with a motion for relief from the stay, and the conundrum which occurs if you record a mechanics' lien, but do not file the required complaint to foreclose, before the developer files bankruptcy.

### Motion for Relief from Automatic Stay

Upon the filing of bankruptcy by the developer, a statutory injunction (the "automatic stay") takes effect and precludes all collection activity pursuant to 11 U.S.C. §362. At this time, absent unusual circumstances, you cannot foreclose, attempt to collect, or commence any legal action against the bankrupt party. See, 11 U.S.C. §362(a) for a full list of prohibited actions and 11 U.S.C. §362(b) for a list of exceptions to the automatic stay.

In order to foreclose on the property to which your lien attaches, you must first obtain relief from the automatic stay. Obtaining relief from the automatic stay requires a motion, a hearing, and an opportunity for response by the developer.

Only the general provisions are covered here, but there are many other nuances to the automatic stay and to obtaining relief from the stay. See, 11 U.S.C. §362 for a full discussion. In general, to prevail on a motion for relief from stay, you must show either "cause" or that the property has no equity. See, 11 U.S.C. §362(d). "Cause" can include, among other things, lack of adequate protection. A secured creditor can show it is not adequately protected if it is not covered by an adequate equity cushion. The allowable equity cushion varies depending on the court and the circumstances of the case, but some courts require more than a 20% cushion. *Bragg v. Mellor (In re Mellor)*, 734 F.2d 1396, 1401 (9th Cir. 1984). We must caution that the calculation for "equity cushion" is different from the calculation for equity. The "equity cushion" is calculated using only the amount of the moving party's lien and any liens senior to the moving party's lien. In other words, junior liens are not included in the "equity cushion" calculation. In contrast, when determining the equity in the property, all liens are considered.

### "Trip Wires" to Avoid

In order to obtain relief from stay quickly and painlessly, it is important that you do not overlook the following requirements:



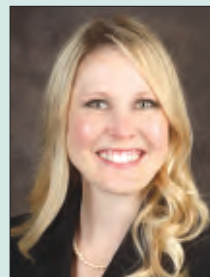
- ◆ All necessary parties must be served. "Necessary parties" includes all junior lienholders.
- ◆ Use all mandatory forms. Check the court's website and local rules for any mandatory forms.
- ◆ You must include sufficient documentation to prove to the court that you have properly recorded your lien against the property.
- ◆ Although it is not required, you should have a recent and proper appraisal report for the property. If not, and an opposing party provides an appraisal evidencing the property is worth more than you do, you may lose your motion.
- ◆ You will need a sworn declaration, which may be included in the mandatory forms.

If all necessary documents are not filed, you may lose your motion or may have to appear in court more than once to obtain relief, both of which will cost time and money.

### Special Steps to Take in the Case of a Mechanics' Lien

In the case of a mechanics' lien, certain additional requirements must be met. Generally in California, a complaint for foreclosure must be filed within ninety days of the recording of a mechanics' lien or else the lien is irretrievably lost. See, Cal. Civ. Code §3084. If the developer

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deciding when and how to deploy SIP. Each company faces its own set of unique needs and hurdles. For example, a local consulting company with a mobile work force has a different set of problems than a national retail chain with locations across the country. Additionally, the choice to deploy a new IP-based PBX to enable SIP depends greatly on the particular situation of the business. If a PBX is right-sized and fairly current, it may not make sense to replace it. But if a business is outgrowing its current PBX equipment, it may make sense to upgrade to an IP-enabled PBX to benefit from the promise of SIP.

The decision to implement SIP cannot be made without understanding two key issues: interoperability and E911. For a company to ensure a smooth transition to SIP, it is of critical importance to verify that a service provider has demonstrated capability between in network and the IP-PBX equipment being deployed. Additionally, the service provider must endure E911 availability and correct routing for employees. In the world of SIP where trunks can be virtual, it's much more complex to ensure E911 effectiveness. These two issues must be addressed when considering a transition to SIP.

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**DEVELOPER FILES BANKRUPTCY**

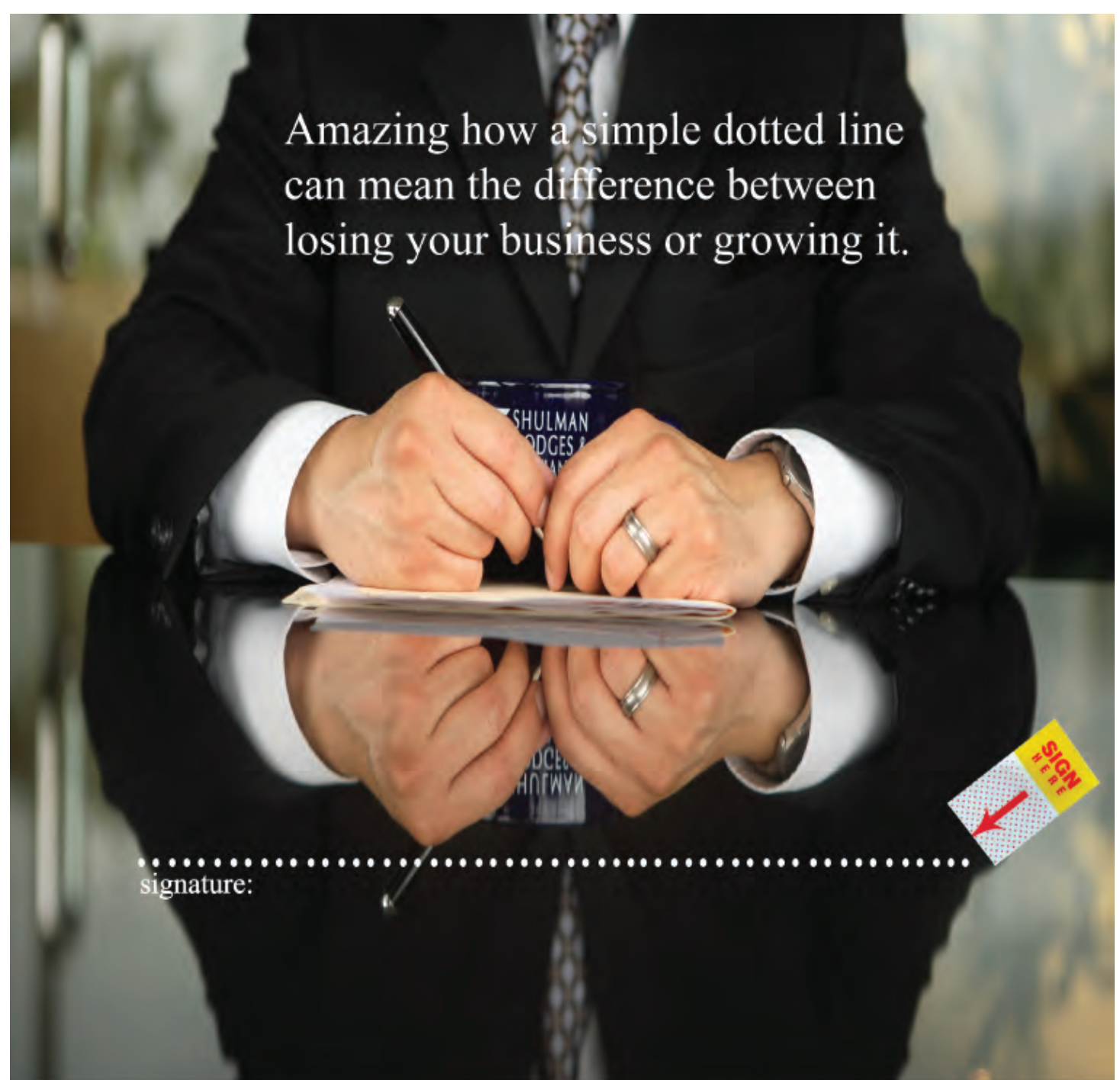
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files bankruptcy after the mechanics' lien is recorded, but before the complaint has been filed, there is a split of authority as to what your next step must be. On the one hand, the automatic stay is in place and as such, you are precluded from commencing any legal action against the developer. On the other hand, the ninety day rule says you must file a complaint.

The Ninth Circuit has held that you must give some form of notice to parties involved in the bankruptcy proceeding, rather than foreclosing on the mechanics' lien in state court. *Village Nurseries v. Gould (In re Baldwin Brothers)*, 232 B.R. 406, 415 (9th Cir. B.A.P. 1999). Many practitioners are uncomfortable with this holding which seems to result in the lienholder violating the California ninety day rule. Regardless, the general rule for meeting the notice requirement is that you file a "Notice of Perfection of Mechanics' Lien" in the bankruptcy case pursuant to Bankruptcy Code Section 546(b). The Notice of Perfection of Mechanics' Lien must be filed within the same amount of time required to file a complaint for foreclosure, i.e. ninety days after the mechanics' lien was recorded.

**Conclusion**

The Bankruptcy Code provides a framework for a lienholder to obtain relief from the automatic stay and foreclose on its lien when a developer files bankruptcy. Many "trip wires" exist, such as knowing to provide notice if you have a recorded mechanics' lien, and serving all junior lienholders with a motion to obtain relief from the automatic stay. In order to obtain the quickest relief possible, you must be aware of, and follow, the procedural rules and requirements.



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