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Feature

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Halting the Race to the Courthouse

Limits of Post-Petition Lien Filings under §§ 362(b)(4), 546(b)

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Once upon a time, creditors were just happy to get paid before a debtor filed a bankruptcy case. Recently, however, simply being paid in full has not been enough for some creditors, and recipients of pre-petition payments have become increasingly creative in trying to protect themselves from potential future avoidance actions. For example, certain payees have made a practice of perfecting liens against debtors' property in an attempt to secure prospective preference liability—despite having been paid in full and with no adversary proceedings in sight. Debtors have responded by seeking to enforce the automatic stay and to nullify these post-petition liens. In a recent case of first impression in Delaware, a debtor successfully argued that a creditor violates the stay by perfecting a lien where there is no underlying obligation and no avoidance action has been commenced.

The Lien Perfection Exception to the Automatic Stay

Section 362 of the Bankruptcy Code generally prohibits taking post-petition actions against the property of a debtor. In particular, § 362(a)(4) bars "any act to create, perfect or enforce any lien against property of the estate." This blanket prohibition is only modified to the extent of the various exceptions listed in § 362(b). One such exception, § 362(b)(3), exempts "any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of the title." Section 546(b) provides, in pertinent part, that

> (b)(1) The rights and powers of a trustee under...this title are subject to any applicable law that—
>
> (A) permits perfection of an interest in property to be effective against an entity that acquires such rights before the date of perfection.

In essence, § 546(b)(1)(A) creates a carve-out to the automatic stay that allows creditors with certain types of state statutory liens to perfect their liens post-petition. According to the legislative history, "[t]he purpose of the subsection is to protect, in spite of the surprise intervention of bankruptcy petition, those whom State law protects by allowing them to perfect their liens or interests as of an effective date that is earlier than the date of perfection."[1] While the legislative history cites provisions of the Uniform Commercial Code (UCC) relating to the perfection of purchase money security interests, a more common example of such "applicable laws" are state mechanic's and materialman's statutes (M&M statutes). M&M statutes allow individuals who provide labor, services or materials that improve the subject property to secure their payment by filing a lien on the property pending payment.

Mechanic's, Materialman's Liens

For example, N.Y. Lien Law § 3 provides that "[a] contractor, subcontractor, laborer [or] materialman...who performs labor or furnishes materials for the improvement of real property...shall have a lien for the principal and interest, of the value, or the agreed price, of such labor...or materials upon the real property improved or to be improved and upon such improvement, from the time of filing a notice of such lien."[2] Similar statutes exist in some form in every state.[3]

Generally, the lien representing a security interest under an M&M statute automatically attaches (although it is unperfected) at the moment the performing individual commences work on the

1 S. Rep. No. 95-989, at 86 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6327.
2 N.Y. Lien Law § 3 (McKinney 2011).
3 *See, e.g.*, Colo. Rev. Stat. § 38-22-101 (West 2012) (providing general mechanic's lien on real property).

subject property. An M&M lien is perfected by filing the appropriate records specified by state law, and most state laws provide that perfection relates back to the date the lien attached. When the applicable state M&M statute provides for such "relation back" of the perfection, courts have read § 546(b) to allow post-petition perfection notwithstanding the automatic stay.[4]

Section 546(b) operates to prevent a bankruptcy filing from unfairly frustrating a creditor's state law lien rights, but what if the service provider has been paid and therefore state law affords no lien rights? Enterprising materialmen have begun to argue that even if they have no claim, the fact that they received payments during the preference period entitles them to perfect a lien on the debtor's property against the possibility of having to return the payment they received. In a recent decision in two parallel adversary proceedings commenced by debtor-in-possession Delta Petroleum Corp., a public oil and natural gas exploration and production company, Hon. **Kevin J. Carey** of the U.S. Bankruptcy Court for the District of Delaware held that the filing of post-petition liens where there is no debt (and therefore state law does not sanction filing a lien) is a *prima facie* violation of the automatic stay.[5]

The *Delta Petroleum* Case

Delta brought adversary proceedings against Baker Hughes Oilfield Operations Inc., d/b/a Baker Oil Tools, and Knight Oil Tools LLC, d/b/a Knight Fishing Services (together, the "defendants") in Delta's chapter 11 proceedings. The defendants, both oilfield service companies, independently provided supplies for and performed work on a number of Delta's oil and gas wells in Colorado. Delta paid both defendants for their services in full during the 90-day period prior to the petition date.

Thereafter, the defendants, fearing potential preference liability, filed and recorded numerous post-petition liens against Delta's wells to secure the payment of the amounts they received in the event such payments were later avoided as preferences (the "contingent preference liens"). Relying on § 546(b), the defendants claimed that their actions did not violate the automatic stay because they would have been able to file liens under Colorado law to secure the payment of such amounts had they not been paid.

Delta commenced adversary proceedings seeking to declare the contingent preference liens null and void, and sought temporary restraining orders and preliminary injunctions enjoining the defendants from filing additional contingent preference liens, directing the defendants to remove and terminate the contingent preference liens and declaring that the contingent preference liens violated the automatic stay and were therefore void.

The defendants argued that Colo. Rev. Stat. 38-24-101—Colorado's special oil and gas M&M statute—provided the statutory basis for the contingent preference liens. That statute provides, in pertinent part, that "[e]very person...who performs labor upon or furnishes machinery...or supplies... any gas, oil well or other well...shall have a lien to secure the payments thereof...to the extent of the right, title and interest of the owner...at the time the work was commenced or... materials, and supplies were begun to be furnished by the lien claimant."

While the lien rights afforded by Colo. Rev. Stat. 38-24-101 "relate back" to the date work is commenced,[6] Colorado law further requires that a debt exist against property intended to be encumbered by a lien for such a lien to be valid.[7] Since the defendants had already been paid in full for their services with respect to the contingent preference liens, there was no such debt for the contingent preference liens to secure. Accordingly, the defendants had no right to file or perfect liens under Colorado law and consequently under the Bankruptcy Code.

The defendants argued that the contingent preference liens presented a case of "no harm, no foul" to Delta since the liens were contingent in nature until such time, if ever, that the pre-petition payments were avoided as preferences. Moreover, the defendants pointed out that if the pre-petition payments were avoided, which in turn would reinstate the debt and give the defendants the right to perfect a lien to secure its payment, the defendants would be prejudiced by having missed the statutory deadline for perfecting an M&M lien.[8]

Just four days after Delta commenced the action and two days after a temporary restraining order was issued enjoining the defendants from filing further contingent preference liens, the court sided with Delta, ruling that the defendants' actions violated the automatic stay since they did not secure any outstanding indebtedness as required under Colorado law. In addition, the court held that the violation of the automatic stay constituted *per se* irreparable harm. The court declared the contingent preference liens void, enjoined the defendants from filing additional contingent preference liens and directed them to remove and terminate all existing contingent preference liens. At the injunction hearing, Judge Carey highlighted the Pandora's box of issues that could open were creditors permitted to file post-petition liens such as the contingent preference liens:

> If I look at public policy, it's clear to me that if the defendant[s] were entitled to the relief that [they] claim...any party who has such rights would be able to concoct possible contingent future liabilities, whether it's preference, fraudulent transfer or some other theory of recovery that some [d]ebtor might bring. I think that would just wreak havoc on the system and completely vitiate the stop on the race to the Courthouse that the automatic stay is intended to apply and would go far beyond the limited exception that the drafters of the code provided in Section[s] 546(b) and 362(b)(3).[9]

4 *See, e.g., In re Yobe Electric Inc.*, 728 F.2d 207 (3d Cir. 1984); *In re Aznoe Agribiz Inc.*, 416 B.R. 755 (Bankr. D. Mont. 2009); *In re United Inc.*, 327 B.R. 776, 785 (Bankr. E.D. Va. 2005); *In re Victoria Grain Co.*, 45 B.R. 2 (Bankr. D. Minn. 1984); *In re Fiorillo & Co.*, 19 B.R. 21 (Bankr. S.D.N.Y. 1982).

5 Injunction against Knight Oil Tools LLC, d/b/a Knight Fishing Services, at 3, *Delta Petroleum Corp. v. Knight Oil Tools LLC, d/b/a Knight Fishing Services*, Adv. Proc. No. 12-150407 (Bank. D. Del. March 23, 2012) [Docket No. 21]; Injunction against Baker Hughes Oilfield Operations Inc., *d/b/a Baker Oil Tools*, at 3, *Delta Petroleum Corp. v. Baker Hughes Oilfield Operations Inc., d/b/a Baker Oil Tools*, Adv. Proc. No. 12-50408 (Bank. D. Del. March 23, 2012) [Docket No. 20].

6 *Schiffer v. Arvada Steel Fabricating Co. (In re Cantrup)*, 38 B.R. 148, 150-51 (Bankr. D. Col. 1984).

7 *See, e.g., Sperry & Mock Inc. v. Security Savings*, 549 P.2d 412, 414 (Colo. Ct. App. 1976) ("A prime requisite to the establishment of a valid lien is that an indebtedness exists in favor of the claimant.").

8 *See, e.g., In re Prudential Lines Inc.*, 107 B.R. 832, 835 n. 4 (Bank. S.D.N.Y. 1989) ("Congress, by legislatively staying such acts, has determined that they cause irreparable injury to the estate.").

9 Transcript of Hearing at 26-27, *Delta Petroleum Corp. v. Knight Oil Tools LLC, d/b/a Knight Fishing Services*, Adv. Proc. No. 12-150407 (Bank. D. Del. March 9, 2012) [Docket No. 16]; *Delta Petroleum Corp. v. Baker Hughes Oilfield Operations Inc., d/b/a Baker Oil Tools*, Adv. Proc. No. 12-50408 (Bank. D. Del. March 9, 2012) [Docket No. 16].

Impact of the Decision

While Judge Carey's opinion is narrowly tailored to contingent preference liens, its impact is clear: Absent an express statutory right, creditors cannot act to perfect a lien post-petition without violating the automatic stay. While this may put creditors in the position of having to fight to be able to perfect their liens after losing an avoidance action (and thereby getting their claims back), Judge Carey's opinion illustrates that the sanctity of the automatic stay takes precedence over such concerns and must be enforced absent legislative action to the contrary. abi

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