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In re Municipal Corrections, LLC

United States Bankruptcy Court, N.D. Georgia, Atlanta Division - September 30, 2013 - Slip Copy - 2013 WL 5534237

In an unrecorded trust indenture agreement for the issuance of tax-exempt bonds, Municipal Corrections, LLC (“Debtor”), the Chapter 11 debtor in possession in this case, “pledged and assigned” its interest in its real property to secure its obligation to pay the bonds. The indenture trustee for the bondholders is the defendant UMB, N.A. (together with Bank of Oklahoma, N.A., the original trustee, the “Bond Trustee”). The Bond Trustee is the legal holder of the security interest on behalf of the bondholders.

The Debtor sought a determination of the nature, extent, and validity of the Bond Trustee’s lien on the real property, contending that it has no such lien. In addition, they sought the avoidance of any lien the Bond Trustee has on the real property under 11 U.S.C. § 544(a)(3) on the ground that it is unenforceable against a hypothetical bona fide purchaser under Georgia law.

The dispute presented two questions arising under Georgia real estate law. The first is whether the “pledged and assigned” language in the indenture agreement created a mortgage in favor of the Bond Trustee. If so, the second question is whether other recorded documents and an order of the Superior Court validating the bonds provide constructive notice of the unrecorded interest or give rise to a duty of inquiry such that the unrecorded interest is nevertheless enforceable against a purchaser. If they do not, any interest of the Bond Trustee is avoidable under 11 U.S.C. § 544(a)(3), which permits a bankruptcy trustee (or a Chapter 11 debtor in possession with the powers of a trustee under 11 U.S.C. § 1107(a)) to avoid an interest in real property that a hypothetical bona fide purchaser could avoid under applicable state law.

The Court concluded as matters of law that the Indenture gave the Bond Trustee a mortgage on the real property and that it is enforceable against a bona fide purchaser under principles of constructive and inquiry notice that apply under Georgia law.

The good folks at Baker Donelson were kind enough to make available the entire Order Granting Indenture’s MSJ, which is available here:

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