**Allowing Service by Non-petitioning Creditors**

**in an Involuntary Case**

**Closing an Open Door to Bankruptcy Abuse**



**History:** Around the time of the mortgage meltdown a number of foreclosure rescue businesses started up offering creating solutions for avoiding foreclosure. Among the options being offered to stave off foreclosure were fractional interest schemes, in which a property owner would be offered to sell the property for a nominal fee, often $1.00, and the business in return would receive a small portion of the title interest in return.

“In some property transfers, the homeowner is instructed to transfer only a fractional interest in the property to the perpetrator who then transfers that interest to another individual or entity (often fictitious). Often, the fractional interest is transferred numerous times as the automatic stays are lifted, which delays foreclosure for months and generates additional proceeds for the perpetrators. According to the Executive Office of US Trustees, one residential property was linked to 24 different bankruptcy cases.”

Federal Bureau of Investigation Mortgage Fraud Report 2008. <https://www.fbi.gov/stats-services/publications/mortgage-fraud-2008>

In Maryland, if a title holder files bankruptcy, the bankruptcy stay prevents the continuation of foreclosure proceedings until the bankruptcy stay is lifted or terminated.

# Maryland is no stranger to these schemes. “From September 2004 to June 2007, Jennifer McCall conspired with others in a scheme to fraudulently promise to help homeowners, who had substantial equity in their homes but were facing foreclosure because of their inability to make monthly mortgage payments, avoid foreclosure and repair their damaged credit. The homeowners were directed to allow title to their homes to be put in the names of third party purchasers (the straw buyers) for a year….” *CEO of Metropolitan Money Store Pleads Guilty in Mortgage Fraud Scheme,* United States Attorney’s Office, Maryland (December 7, 2009). <https://www.justice.gov/archive/usao/md/news/archive/CEOofMetropolitanMoneyStorePleadsGuiltyinMortgageFraudScheme.html>

# Current Twist on Scheme: Rather than a foreclosure rescue company assisting a property owner to avoid foreclosure, now we are seeing the owner themselves take steps to prevent foreclosure through the transfer of title to numerous fractional interest holders.

# Single Case Study –

# Subject Case concerns 3960 Decker Edison Road, Malibu, CA 90265

# 11/4/22 – Original owner defaults under mortgage loan.

# 5/3/23 – Original Owner deeds the property to himself and another person.

# 9/21/23 – Original Owner deeds his remaining interest in the property to a third person.

# 3/13/24 – Grow SEO, LLC files bankruptcy in the US Bankruptcy Court for the District of Idaho – 24-40115. Grow SEO, LLC reports it holds a title interest in the property.

# First foreclosure sale stopped.

# 5/2/24 – Original Owner files bankruptcy in the US Bankruptcy Court for the Central District of California Case No. 9:24-bk-10478. Original Owner still is grantor and borrower.

# 5/2/24 – Three petitioning creditors file an involuntary petition for relief for 1705 Carla Ridge LLC, US Bankruptcy Court for the Central District of California. Case No. 1:24-bk-10675-MB. In the case, an unrecorded copy of a 10% interest deed in the property is filed to show the LLC holds a portion of title.

# Second foreclosure cancelled.

# Case dismissed for failure of proper service.

# 5/6/24 – Entity named 3960 Decker Trust purports to transfer an interest in the property to Art & Luxury, Inc. through a deed recorded in the land records.

# 6/18/24 - Three petitioning creditors file an involuntary petition for relief for Art & Luxury, Inc., in the US Bankruptcy Court for the District of Maryland, Case No. 24-15123-DER.

# 8/5/24 – The first Art & Luxury, Inc. bankruptcy case is dismissed for failure of the petitioning creditors to make service.

# 8/6/24 – Three different petitioning creditors file an involuntary petition for relief for Art & Luxury, Inc., in the US Bankruptcy Court for the District of Maryland, Case No. 24-16618 NVA.

# 8/6/24 – Third foreclosure sale is cancelled.

# In Case No. 24-16618 NVA – Determination made that the case impacted the ability to sell other properties, including a property located at 9739 Fox Estate Street, Las Vegas, Nevada 89141

# Lender secured against Las Vegas property had foreclosed and sought to annul the stay to validate the foreclosure. The lender lacked knowledge of the bankruptcy case when the property sold at foreclosure.

# Creditors’ counsel sought various forms of relief from stay and court indicated a due process issue existed due to lack of service upon the debtor.

# Relevant Law

* 11 U.S.C. § 303(b) provides, “[a]n involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title . . . .” 11 U.S.C. 303(b).
* An estate is created the moment a bankruptcy petition is filed, comprising of “all legal or equitable interests of the debtor in property. . . .” 11 U.S.C. 541(a)(1).
* When a bankruptcy estate is created, “it immediately encompass[es] all of the [d]ebtor’s property.” *In re Stillwater Inc.*, 443 B.R. 714, 717 (Bankr. W.D. Va. 2011).
* A bankruptcy court has “exclusive jurisdiction of all the property, wherever located, of the debtor as of the commencement of the case, and of property of the estate . . . .” 28 U.S.C. 1334(e)(1).
* A court exercising “*in rem* jurisdiction alone, is constitutionally empowered to adjudicate rights to property” when such property is legally within its jurisdiction. *In re Globo Comunicacoes E Participacoes S.A.*, 317 B.R. 235, 251 (S.D.N.Y. 2004); *Cf. Lehman Bros. Special Fin. Inc. v. Bank of Am. N.A. (In re Lehman Bros. Holdings)*, 535 B.R. 608, 627-29 (Bankr. S.D.N.Y. 2015) (Holding that a bankruptcy court may exercise *in rem* jurisdiction over an adversary defendant’s property, even though it lacked *in personam* jurisdiction over the defendant, because the debtor had an interest in such property and therefore, it become property of the estate pursuant to 11 U.S.C. § 541(a)).
* A bankruptcy court may enter such relief against an involuntary debtor as long as due process is satisfied, even absent proof that the debtor was properly served with the petition and summons. *See* Fed. R. Bankr. P. 9014 (“[R]elief shall be requested by motion, and *reasonable notice and opportunity for hearing* shall be afforded the party against whom relief is sought.”) (Emphasis added).
* 11 U.S.C. § 102 defines, “after notice and hearing” as “such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances.” 11 U.S.C. § 102(1)(A). Thus, “the concept of ‘notice and hearing’ is a flexible one” and “does not need to be perfect; it must only be reasonable based upon the circumstances of the case.” *Gonzalez-Ruiz*, 341 B.R. at 381.
* Cases finding imperfect notice was still sufficient notice, and others can serve.
	+ Rule 7004(a) “personal service . . . may be made by any person at least 18 years of age who is not a party, and the summons may be delivered by the clerk to any such person.” “[S]ervice may be made within the United States by first class mail postage prepaid . . . .” U.S.C.S. Bankruptcy R 7004(b).
	+ *In re Hutter Assoc., Inc.*, 138 B.R. 512 (W.D. Va. 1992) the summons and involuntary petition was served by regular first class mail on the debtor by the Deputy Clerk of the Bankruptcy Court. “Even had [the debtor] not received the summons and petition, the bankruptcy court’s ruling would still have been correct, because, so long as the debtor has service ‘reasonably calculated to give him actual notice of the proceedings,’ the requirements of due process are satisfied.”

**Results**: Case No. 24-16618 NVA was dismissed for proper service. The Court also indicated that it was not clear that the case was filed in the proper district, as the debtor was not registered to do business in Maryland.

**Counterargument**: An argument can be made that someone other than a petitioner can serve a Debtor in an involuntary case. If at that time the debtor believes the district is improper or service is improper, leave it to the debtor to make that argument.

**Subsequent and Related Activity**

* 8/12/24 - Black Oak Global, LLC files a voluntary chapter 11 case with a “skeletal” petition in the US Bankruptcy Court for the Central District of California, Case No. 8:24-bk-12016-SC. Attorney is Robert Kent.
* Black Oak claims to now own half of the title interest in the Malibu property. US Trustee seeks dismissal for failure to comply with Chapter 11 requirements.
* 10/3/24 – Case dismissed while motion by creditors seeking relief from stay is pending. Debtor seeks to vacate dismissal.
* 10/23/24 – Motion for relief pending by creditor.
* 10/25/24 – Debtor withdraws motion to vacate dismissal.
* 10/30/24 – Order granting relief from stay as to Black Oak interest is granted.
* 11/13/24 – Court indicates hearing was held on motion to vacate dismissal – no order is entered.
* 10/8/24 – Coastal Ventures I LLC files a voluntary chapter 11 case in the US Bankruptcy Court for the Central District of California, Case No. 8:24-bk-12553-SC. Attorney is Robert Kent.
* 10/8/24 – Show cause order as to dismissal and discipline for counsel issued.
* 10/25/24 – Order entered granting stay relief, dismissing case and referring counsel for discipline.
* 7/8/24 – Involuntary petition filed in the US Bankruptcy Court for the District of Maryland, Case No. 24-15697-MHH for Manuel Zargoza Family Trust.
* Creditor and not debtor claims interest in the Decker property.
* 8/28/24 – Case dismissed for failure to make required filings.
* A minimum of six interest holders in the real estate is known from public records prior to when any foreclosure could occur.

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