NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF WASHINGTON

In Re: ADAMS, KATHY, Debtor(s).	No. 98-03428-W1E Adv. No. A99-00091-W1E
KATHY ADAMS, Plaintiff(s), vs. VERA IRRIGATION DISTRICT #15 d/b/a VERA WATER & POWER, Defendant(s).	MEMORANDUM DECISION RE: DEFENDANT'S MOTION TO DISMISS AND/OR MOTION FOR SUMMARY JUDGMENT

THIS MATTER came on for hearing before the Honorable Patricia C. Williams on March 20, 2000 upon Defendant's Motion to Dismiss and/or Motion for Summary Judgment. Plaintiff was represented by Timothy Durkop and Defendant was represented by Joseph Carroll. The court reviewed the files and records herein, heard argument of counsel and has been fully advised in the premises. The court now enters its memorandum decision.

I.

FACTS

The plaintiff/debtor commenced this Chapter 7 proceeding on June 3, 1998. At that time, debtor was past due for utility charges owed to Vera Irrigation District, the defendant herein. On June 13, 1998,

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T.S. McGREGOR, CLERK
U.S. BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

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notice of the bankruptcy filing was sent by the Bankruptcy Noticing Center in Virginia. As of June 15, 1998, the defendant had not received notice of the bankruptcy filing and on that date, pursuant to its normal procedures, had delivered a notice to plaintiff indicating that if the then existing delinquency of $111.57 were not cured by June 16, utility services would be terminated. Defendant paid the delinquency at that time.

Once the bankruptcy notice was received by defendant, it estimated the additional pre-petition charges which were not past due at the time of the delivery of the notice to the plaintiff on June 15 and estimated the then accrued post-petition charges. In accordance with its normal policies, the defendant segregated the pre-petition obligation from the charges which had accrued post-petition. On February 18, 1999, after the discharge had been entered, the plaintiff was mailed a notice which sought payment of the pre-petition delinquency and stated that if that amount were not paid, additional charges would be added for a total due of $121.23. The notice also stated that if not paid, that amount would become a lien against the plaintiff's real estate which lien could be foreclosed. The amount was not paid and on March 5, 1999 the amount of $121.23 was certified delinquent by the plaintiff.

On April 1, 1999, plaintiff was billed for current post-petition charges in the amount of $55.72. That amount was not paid timely and on May 17, 1999 the defendant delivered to plaintiff's home a notice that utilities would be terminated unless payment were received by the following day. Defendant admits that the Notice erroneously included not only the post-petition amount of $55.72, but contrary to defendant's normal policy, the pre-petition amount of $121.23. Plaintiff did not

pay and the following day utility service was terminated. This precipitated the involvement of counsel for both parties and the discovery of the error. Plaintiff then paid the defendant an amount sufficient to satisfy the post-petition amount and the power was restored. This lawsuit followed.

Plaintiff alleges that the defendant violated the automatic stay by delivery of the Notice of June 15, 1998 which contained the threat of terminating utility service. Plaintiff alleges that the delivery of the May 17, 1999 Notice which erroneously included the pre-petition charges violated the permanent injunction as did the defendant's Certification of the Delinquency on March 5, 1999. The defendant requests the case be dismissed as its utility charges are liens upon debtor's real estate which pass through bankruptcy unaffected and defendant was merely enforcing its valid lien rights against the property. Alternatively, it argues that such charges are taxes which are not dischargeable and thus collection efforts could not have violated the permanent injunction.

II.

ISSUES

1. Did the Notice of June 15, 1998 constitute an attempt to collect a pre-petition debt and thereby violate the automatic stay provisions of 11 U.S.C. § 362(h)? If so, what is the appropriate remedy?

2. Did the Notice of February 28, 1999 and the Certificate of Delinquency constitute actions to assess personal liability or were they state statutorily mandated steps of lien enforcement?

3. Did Vera Irrigation District have a perfected and enforceable lien at the time of filing such that the lien would pass through

bankruptcy unaffected?

4. Was the Notice of May 17, 1999 a part of the statutorily mandated lien enforcement process or was it an attempt to hold the debtor personally liable for a discharged debt, thereby violating the injunction imposed by 11 U.S.C. § 524(a)(2)? What is the appropriate measure of damages for a violation of the § 524 injunction?

5. Are the pre-petition utility charges nondischargeable as they constitute a tax claim of a governmental unit as described in 11 U.S.C. § 507(a)(8)?

III.

DISCUSSION

Pursuant to R.C.W. 87.03.445, an irrigation district may finance its operating, maintenance and improvement costs by issuing bonds, by assessing rates or charges, or by a combination of both. If the district determines to assess rates or charges, the board may either have those charges collected by the County Treasurer or may collect them itself. The defendant has elected the "alternative method" referenced in R.C.W. 87.03.445(5) which is to collect the charges itself.

> . . . The board shall enforce collection of such rates or tolls and charges against property to which and its owners to whom the service is available, such rates or tolls and charges being deemed charges against the property to which the service is available. . . .

Subsection (4) which describes the procedure to be utilized when the County Treasurer collects the charges provides that the ". . . charges levied shall also at once become and constitute an assessment upon and against the lands . . . ." Subsection (6) allows, but does not mandate, a procedure by which, once a district determines that charges are delinquent for a specified period of time it " . . . shall certify

the delinquencies to the treasurer of the county in which the real property is located, and the charges and any penalties added thereto and interest thereon . . . shall be a lien against the property to which the service was available, subject only to the lien for general taxes. . . ." The language in subsection (5) differs not only from the language used in subsections (4) and (6), but also from language in other statutes concerning utility liens. Various other statutes specifically provide that the entity providing utility services "shall have a lien" for delinquent charges or fees.[1]

Because the language in subsection (5) differs from other statutory language expressly providing for a lien, the initial question is whether the defendant has state law lien rights when it elects the "alternative method" in subsection (5). I conclude that it does. Despite the fact that in subsection (5) the Washington legislature did not utilize specific language similar to that in other utility lien states, reading R.C.W. 87.03.445 as a whole it is apparent that the legislature granted an irrigation district the rights to have its charges become a lien regardless of whether the County Treasurer or the district itself collects the charges.

Concluding that utility districts such as the defendant have the statutory right to have their charges become liens against the real

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[1]R.C.W. 36.36.045 regarding aquifer protection districts states "The county shall have a lien for any delinquent fees imposed . . . ." R.C.W. 36.89.090 regarding storm water control facilities states: "The county shall have a lien for delinquent service charges, including interest thereon, against any property against which they were levied . . . ." R.C.W. 36.94.150 regarding sewerage water and drainage systems states "All counties operating a system of sewerage and/or water shall have a lien for delinquent collection charges . . . ."

property does not end the analysis of whether these attempts to collect these particular charges violate the automatic stay or permanent injunction. Each collection attempt must be analyzed separately.

A. <u>The Notice of June 15, 1998</u>.

11 U.S.C. § 362(a)(1) prevents actions or proceedings against a debtor to enforce a claim which arose pre-petition. Subsection (4) prevents any acts to enforce any lien against property of the estate and subsection (6) prevents acts to enforce any lien against property of the debtor. If the defendant's statutory lien did exist as of June 15, then the Notice was precluded by subsection (4) as it was an attempt to enforce a lien against property of the estate. Subsection (6) prevents any act to recover a pre-petition claim against the debtor. If the defendant's statutory lien had not yet come into existence on June 15, and defendant at that time was simply an unsecured creditor without any lien rights, the June 15, 1998 Notice was certainly an attempt to recover a pre-petition claim against the debtor. Consequently, it is immaterial whether the state law lien existed on June 15 as § 362 precluded defendant from taking the action it did.

It is undisputed that at the time the notice was provided, the defendant had no knowledge of the bankruptcy proceedings. Since the defendant was not aware of the bankruptcy proceeding, its attempt to collect is a technical violation of the automatic stay but it was not willful as that term is used in § 362(h). It would not only be inappropriate to assess punitive damages, but actual damages are assessed only when the defendant knew of the bankruptcy filing and acted intentionally. *McHenry v. Key Bank (In re McHenry)*, 179 B.R. 165 (9th Cir. BAP 1995). Although this attempt to collect was a violation of the

automatic stay, it occurred without knowledge of the existence of the bankruptcy case. Thus no compensatory damages will be awarded.

B. <u>The Notice of February 18, 1999 and the Certification of the Delinquency of March 5, 1999</u>.

The discharge was entered on December 2, 1998 and the case was closed on the same day. Defendant alleges and the plaintiff does not dispute that both the February 18 Notice and the March 5 Certification were statutorily required steps to create and fix its lien against the property. Plaintiff argues that the pre-petition debt was discharged as under state law the lien had not yet come into existence when the case was filed. Accordingly, the defendant did not have a lien against the property which was enforceable against the property when the Notice and Certification were sent.

The Hypothetical Bona Fide Purchaser Test Under § 545(2).

A bankruptcy trustee may avoid the fixing of a statutory lien under § 545(2) on the debtor's property if the lien " . . . is not perfected or enforceable at the time of the commencement of the case against a bona fide purchaser that purchases such property at the time of the commencement of the case, whether or not such a purchaser exists . . . ."

Even though a creditor may have enforceable rights against the debtor and may have rights against the debtor's property, if those rights are not enforceable against a bona fide purchaser at the time of the commencement of the case, they are not enforceable against the bankruptcy trustee and are voidable by the bankruptcy trustee. To determine whether that hypothetical bona fide purchaser would have

acquired property subject to a statutory lien against the property, state law must be examined. *In re Badger Mountain Irrigation Dist.*, 885 F.2d 606 (9th Cir. Wash. 1989). If under state law, a third person who purchased or acquired rights in the property on the petition date would have acquired the property subject to the defendant's right to assess the pre-petition charge against the property, then neither the trustee nor debtor may avoid the defendant's right to do so.

The Ninth Circuit analyzed § 545(2) in the context of a California statute in *In re Loretto Winery, Ltd.*, 898 F.2d 715 (9th Cir. 1990). The state statute granted producers of farm products who sold products to processors a lien upon the processed or manufactured form of the farm product. There were no formal recording or perfection requirements in the statute. The debtor winery had purchased farm products, and the trustee sought to avoid the producer's statutory lien under § 545(2). The court stated that the trustee could avoid the lien only if it were unenforceable against a bona fide purchaser under California law. Despite the lack of any notice of the lien and the conflict with the Code's policy of distributing assets evenly among creditors, the proper inquiry was whether the lien was enforceable against a bona fide purchaser under state law. If so, it survived the bankruptcy filing and was enforceable in the bankruptcy proceeding.

The Hypothetical Bona Fide Purchaser Test As Applied To R.C.W. 87.03.

R.C.W. 60.80.010 states that when real property is sold, the owner must satisfy any lien created by R.C.W. 87.03.445. A process must be followed by the real estate closing agent who, unless both seller and purchaser waive the obligation, must determine the unpaid charges due

utility districts and pay those from the closing proceeds. If the process, which also requires utility districts to provide timely billing information to the closing agent, is followed by the closing agent, payment of the billing " . . . extinguishes a lien of the utility . . ." for charges incurred prior to the closing. R.C.W. 60.80.020(3). If the statutory process is not followed, the utility district has the right to recover " . . . from the purchaser of the property unpaid utility charges incurred prior to closing . . . ." R.C.W. 60.80.020(4)(a).

Those unpaid charges which must be paid by the purchaser are all lawful charges of the utility district even though ". . . not evidenced by a recorded lien, recorded covenant, recorded agreement, or special assessment roll filed with the city or country treasurer or assessor, and not billed and collected with property taxes . . . ." R.C.W. 60.80.005. In other words, unpaid utility charges must be paid by the purchaser whether or not the district has opted to collect such charges itself under the alternative method of R.C.W. 87.03.455(5) or have them collected by the taxing authority. The purchaser would have to pay those charges whether or not the utility district has certified the charges delinquent to the county treasurer under R.C.W. 87.03.455(6) or whether they are simply "unpaid".

The statutory scheme in R.C.W. 60.80 essentially requires all unpaid utility charges at the time of the sale of the property to be paid at the closing of the sale. This is true whether they are collected by the county treasurer or the utility district and whether or not they have been certified delinquent or, in fact, are delinquent. If not paid upon closing, the purchaser takes the property subject to the obligation to pay and must either pay the charges or face an action to

foreclose the utility district's lien on the property. When read as a whole, the inescapable conclusion is that a bona fide purchaser acquires an interest in property subject to a utility district's lien rights for unpaid charges. If charges are not paid as a result of the closing of sale, the purchaser may face a foreclosure of the utility district's lien against the property.

If a bona fide purchaser of the debtor's real estate had existed as of June 3, 1998, the date of the commencement of this case, these unpaid utility charges of $121.23 would have been enforceable against the purchaser of the real estate if not paid by the debtor. Since that hypothetical bona fide purchaser could not have avoided the fixing of defendant's lien for unpaid charges, neither could a bankruptcy trustee. That statutory lien, despite the fact that it was unrecorded, passed through the bankruptcy unaffected. Not only does the trustee lack the power to avoid lien rights otherwise enforceable against bona fide purchasers as of the commencement of the case, but the trustee lacks the power to avoid post-petition actions to perfect or continue those lien rights. 11 U.S.C. § 546(b). Consequently, neither the Notice of February 28, 1999 stating that the unpaid charges, if not paid, would become a lien against the property nor the Certification of Delinquency on March 5, 1999 violated § 524(a)(2). The defendant's Certification of the Delinquency under R.C.W. 87.03.445(6) was a step in the enforcement process as was the notice of the delinquency to the debtor. Those were not actions to assess personal liability against the debtor but were state statutorily mandated steps of the lien enforcement process.

C. <u>The Notice of May 17, 1999</u>.

On May 4, 1999, the defendant informed the debtor that post-

petition utility charges of $55.72 were past due and if not paid, utility service would be terminated. The "turn-off notice" left at the premise on May 17 included not only the amount of the post-petition charges of $55.72 but also the pre-petition charges of $121.23. To the extent this Notice was an attempt to collect post-petition debt, it was entirely proper. Unfortunately, defendant admits it erroneously included the pre-petition obligation of $121.23. This Notice, as it related to the pre-petition amount, was not part of the lien enforcement process but appears to be an attempt to hold the debtor personally liable. This Notice violates the injunction contained in § 524(a)(2). Even though defendant had lien rights and could have looked to the real estate for repayment of the pre-petition obligation, the debtor had been discharged from personal liability and any attempt to collect from the debtor personally was improper.

Utility services were terminated on May 18. In response to an inquiry from the debtor's counsel on May 18, the defendant discovered the error in the Notice. That same date it informed debtor's counsel of the error and that the amount due was $55.72. A third party delivered a payment of $150 to defendant's night lock box after hours on May 19 and utilities were restored the morning of May 20. Debtor seeks punitive and actual damages for the error in the Notice which debtor alleges caused the disruption in utility service.

Unlike § 362(h) which provides for actual and punitive damages for a violation of the automatic stay, § 524 contains no specific provision for damages when the permanent injunction is violated. Although courts have awarded actual damages for such violations, a request for punitive damages is usually analyzed under the court's general equitable powers

found in § 105. *Cherry v. Arendall (In re Cherry)*, 247 B.R. 176 (Bankr. E.D. Va. 2000) and *In re Hill*, 222 B.R. 119 (Bankr. N.D. Ohio 1998). Such cases have awarded actual damages under § 524 and generally limited any award of attorney fees or punitive damages to situations involving willful violations of the permanent injunction. This approach is consistent with the statutory language of § 362(h) and the Ninth Circuit's analysis regarding violations of the automatic stay. See *In re McHenry, supra*. In this case, the turn-off notice was precipitated by the unpaid past due post-petition charges. Even though the Notice of May 17, 1999 included the pre-petition charges, defendant corrected that error as soon as it was discovered. These facts do not demonstrate a willful violation of the permanent injunction and do not give rise to a claim for punitive damages.

Further development of the facts surrounding the termination of utility services and payment by the third party of the $150 as a result of the notice is required to determine if the facts justify an award of actual damages. An evidentiary hearing is necessary to elicit those facts and to identify and quantify any actual damages incurred by debtor including any claim for attorney fees relating to the May 17, 1999 Notice.

D. Utility Charges Constitute a "Tax".

As the court has concluded that the defendant has a lien upon the real estate, the issue concerning the nondischargeable tax nature of the obligation has not been addressed.

IV.

CONCLUSION

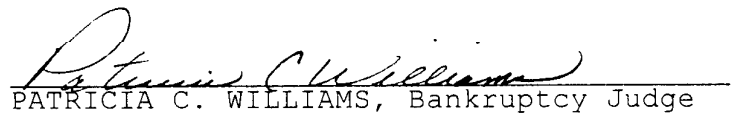
The Notice of June 15, 1998 was an attempt to collect a pre-

petition debt and violated the automatic stay. As the defendant had no notice of the bankruptcy filing when the Notice was sent, punitive damages are inappropriate and, under the facts of this case, an award of actual damages would also be inappropriate. The Notice of February 28, 1999 and the Certification of Delinquency on March 5, 1999 were part of the lien enforcement process under state law and the state law lien rights of defendant had passed through bankruptcy unaffected. Consequently, such acts did not violate the permanent injunction. The Notice of May 17, 1999 did violate the permanent injunction as it was not part of the lien enforcement process. The violation was unintentional and corrected as soon as it was brought to defendant's attention. Punitive damages are therefore inappropriate, but compensatory actual damages may be awarded under § 524. Further evidence is necessary to determine whether damages resulted and the amount of any such damages.

A separate order granting in part and denying in part the defendant's Motion to Dismiss will be entered.

The Clerk of Court is directed to file this Memorandum Decision and provide copies to counsel.

DATED this 15th day of August, 2000.



PATRICIA C. WILLIAMS, Bankruptcy Judge