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Adversary Proceeding Not Required for Bankruptcy Courts to Determine Lien Status

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In *Wells Fargo Bank, N.A. v. AMH Roman Two NC, LLC*,[1] the Fourth Circuit denied Wells Fargo's motion to set aside an order canceling its mortgage because the motion was not timely.[2] In 2002, Wells Fargo extended a mortgage to the debtors on a property in Pendleton, North Carolina.[3] Two years later, debtors refinanced the property with PNC Bank.[4] Although PNC fully repaid Wells Fargo's loan, Wells Fargo allowed the debtors' line of credit to remain open, and permitted the debtors to take advances totaling over $300,000.[5] Then, in 2012, debtors filed voluntary petitions for relief under chapter 13, which triggered an automatic stay on collection efforts outside of the bankruptcy case.[6] PNC filed two proofs of claim against the debtors, while Wells Fargo filed one.[7] Six months later, PNC filed a motion for relief from the automatic stay, seeking to foreclose its interest in the property.[8] Wells Fargo did not respond to PNC's motion.[9] The bankruptcy court entered an order which granted PNC relief from the

[1] Wells Fargo Bank, N.A. v. AMH Roman Two NC, LLC, 859 F.3d 295 (4th Cir. 2017).
[2] *See id.* at 297.
[3] *See id.* at 298.
[4] *See id.*
[5] *See id.*
[6] *See id.*
[7] *See id.*
[8] *See id.*
[9] *See id.*

automatic stay, accorded priority to PNC's mortgage, and canceled Wells Fargo's mortgage.[10] Subsequently, PNC foreclosed on the property and the bankruptcy court's order was recorded in the Wake County Register of Deeds.[11] Thereafter, AMH Roman Two NC, LLC ("AMH") purchased the property relying, in part, on the order cancelling Wells Fargo's mortgage.[12]

After learning that its mortgage was canceled by the bankruptcy court's order, Wells Fargo moved to set aside the order under Federal Rules of Civil Procedure 60(b).[13] Specifically, it argued that the bankruptcy court lacked jurisdiction to cancel the lien because the order resulted from a motion, rather than an adversary proceeding.[14] The bankruptcy court denied the motion to set aside the order canceling the mortgage because the motion was untimely, and because granting the motion would unfairly prejudice AMH.[15] On appeal, the United States District Court for the Eastern District of North Carolina[16] and thereafter the United States Court of Appeals for the Fourth Circuit[17] affirmed the bankruptcy court's order, finding that Wells Fargo failed to act to prevent the foreclosure despite receiving adequate notice and due process.[18] Moreover, the Fourth Circuit noted that AMH was a bona fide purchaser who relied in good faith on the bankruptcy court order when it purchased the property in foreclosure.[19]

Central to Wells Fargo's claim was that Bankruptcy Rule 7001(2) requires an adversary proceeding to determine the "validity, extent, or priority of a lien."[20] However, failure to initiate

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[10] *See id.*
[11] *See id.*
[12] *See id.*
[13] *See id*; *see also* Fed. R. Bankr. P. 9024 ("Rule 60 F. R. Civ. P. applies in cases under the Code.").
[14] *See id.*
[15] *See id.*
[16] Wells Fargo Bank, N.A. v. Farag, 2016 U.S. Dist. LEXIS 66144, 2016 WL 2944561, at *12-13 (E.D.N.C. May 18, 2016).
[17] *See Wells Fargo*, 859 F.3d at 298.
[18] *See id.*
[19] *See id.*
[20] *See id.* at 301.

an adversary proceeding is not a constitutional error and affords no basis to void an order.[21] Congress has vested bankruptcy courts with broad authority to determine the "validity, extent, or priority of a lien,"[22] and the Supreme Court has recognized that this authority flows "from the Bankruptcy Rules . . . , which are 'procedural rules . . . that are not jurisdictional.'"[23] Even if there was a jurisdictional flaw, Rule 60(b) judgments are void "only when the jurisdictional error is 'egregious.'"[24] Absent a showing that an order is void, the ruling of a bankruptcy court is final.[25]

Relying on Congressional intent,[26] the Fourth Circuit in *Wells Fargo* held that "the bankruptcy court acted well within its jurisdiction when it determined the validity, extent, and priority of Wells Fargo's lien."[27] Further, the failure to follow Rule 7001(2) did not "rise to the level of a jurisdictional flaw,"[28] because failing to initiate an adversary proceeding was not *egregious*.[29] Additionally, the court stated that the order canceling Wells Fargo's mortgage was "clear and unambiguous."[30] On a Rule 60(b) motion, the moving party must show that granting the motion would not unfairly prejudice the opposing party.[31] Given this, and the fact that the order was recorded in the register of deeds, the court held that voiding the order would unfairly

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[21] Fed. R. Bankr. P. 7001(2); *see* Anthony McCready, Comment, *Strip-Off: What is the Correct Procedure to Avoid a Wholly Unsecured Junior Mortgage*, 28 EMORY BANKR. DEV. J. 463, 490 (2012) (explaining that the Supreme Court in *Espinosa* did not find that the creditor was deprived of due process, even though the debtor failed to initiate an adversary proceeding).
[22] 28 U.S.C. § 157(b)(2)(K); *see Wells Fargo*, 859 F.3d at 302 n.2 (citing Wellness Int'l Network, Ltd. v. Sharif, —U.S.—, 135 S. Ct. 1932, 1951 (2015) (noting that Congress may assign the restructuring of debtor-creditor relations to non-Article III courts)).
[23] United Student Aid Funds, Inc. v. Espinosa, 559 U.S. at 260, 272, (2010) (quoting Kontrick v. Ryan, 540 U.S. 443, 454 (2004)).
[24] *Wells Fargo*, 859 F.3d. at 302 n.3.
[25] *See In re* Strongs, 569 B.R. 40, 46 n.2 (Bankr. E.D.N.C. 2017).
[26] *Wells Fargo*, 859 F.3d. at 302 n.2 ("The core of the federal bankruptcy power is 'restructuring debtor-creditor relations . . . .'" (quoting Stern v. Marshall, 464 U.S. 462, 492 (2011)).
[27] *Id.*
[28] *Id.*
[29] *Id.* (emphasis added).
[30] *Id.* at 301.
[31] Dowell v. State Farm Fire & Cas. Auto. Ins. Co., 993 F.2d 46, 48 (4th Cir. 1993).

prejudice AMH—a bona fide purchaser—who relied on the recording in good faith when it purchased the property in foreclosure.[32]

The Fourth Circuit's holding in *Wells Fargo* reaffirms the rule promulgated by the Supreme Court in *United States Aid Funds, Inc. v Espinosa* that an adversarial proceeding is not required for a bankruptcy court to determine a lien's status.[33] Indeed, courts have already relied on *Wells Fargo*. For example, in *In re Leviner* the United States Bankruptcy Court for the Western District of North Carolina held that "failure to seek relief through an adversary proceeding does not deprive the bankruptcy court of jurisdiction where adequate due process is afforded."[34] This view was espoused in *In re Strongs* (also relying on *Wells Fargo*), which held that absent a properly filed Rule 60(b) motion, bankruptcy court orders are final and binding.[35] Thus, the holdings of *Wells Fargo* and its progeny foreclose a Rule 60(b) motion as a substitute for a timely and proper appeal,[36] and in doing so prevent unfair prejudice to bona fide purchasers.

[32] *Id.* ("The very purpose of the race recording statute is 'to enable purchasers to rely with safety upon the examination of the records.'" (quoting *Grimes v. Guion*, 18 S.E.2d 170, 172 (1942))); *see* N.C. Gen. Stat. §§ 47-18, 47-20.
[33] McCready, *supra* note 20.
[34] *In re* Leviner, 2017 Bankr. LEXIS 2584 at 12 (Bankr. W.D.N.C. 2017) (citing *Wells Fargo*, 859 F.3d at 301–02).
[35] *See In re* Strongs, 569 B.R. at 46 (citing *Wells Fargo*, 859 F.3d 295).
[36] *See Dowell*, 993 F.2d at 48 ("It is a well settled principal of law that a Rule 60(b) motion seeking relief from a final judgment is not a substitute for a timely and proper appeal.").