

Secured Creditor Allowed to Retain \$80,000 Windfall in Receivership Sale Where Settlement Agent Failed to Pay Priority Real Estate Taxes.

By:



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Assume that you are a lender with a mortgage on commercial property in Rhode Island. The property is now under the custody of a court-appointed receiver, who is looking to quickly liquidate it. Eventually, a buyer is found and a closing is imminent. The property is “under water.” Even in the best-case scenario, you expect to write off a substantial portion of the loan. However, due to an oversight on the part of the settlement agent in failing to pay certain real estate taxes, you receive an extra \$80,000 in sale proceeds. Would you expect to be able to keep this windfall?

This scenario played itself out in a case decided recently by the Rhode Island Supreme Court. In that case, the lender was owed roughly \$500,000. The receiver contracted to sell the real estate for \$400,000. As is customary, the sale would be “free and clear” of all liens for taxes, mortgages, and other liens on the real estate. Those liens would attach to the sale proceeds in order of priority. After deductions from the sale proceeds for certain real estate taxes, the receiver’s fees, and other transaction costs paid at closing, the secured creditor eventually received about \$260,000 in net proceeds.

A few months later, it was discovered that the settlement agent failed to pay about \$80,000 in real estate taxes that should have been paid at the closing from the seller’s proceeds. The error was related to the fact that the property was located partially in Cranston, and partially in Providence. The settlement agent paid the back taxes owed to the City of Cranston, but neglected to pay the taxes owed to the City of Providence.

The Supreme Court ruled that the purchase agreement made payment of these taxes the responsibility of the buyer. Had the error not occurred, the secured creditor’s net proceeds would have been reduced by the \$80,000. When the error was discovered, the buyer and the settlement agent requested the return of the \$80,000, and the secured creditor refused. As a result, the buyer and settlement agent sued the secured creditor, asking the court to compel return of the overpayment.

Ultimately, the Court held that the secured creditor could keep the \$80,000. Even after having received the extra \$80,000, the secured claim was not fully satisfied. However, the bank conceded that it had not “changed its position” based upon having received an extra \$80,000. In other words, it could have returned the money and would be no worse off than if the error had not occurred. Nevertheless, the secured creditor argued that it was an innocent third-party creditor, was not

aware of any error in calculating the taxes owed, and, therefore, should be able to keep the overpayment. The Court agreed, finding that without prior knowledge of the error, “a creditor should be able to treat funds credited in apparent payment of a debt as irrevocably his.” It reasoned that the costs of errors should be born by those who make them. The Court also noted in footnote that it was reluctant to scrutinize distributions to creditors after the fact, as there is a need for finality in insolvency actions.

This case warns receivers and buyers (and their attorneys) to be extra careful, and to pay all liens and other charges in accordance with the parties’ agreement, as any errors will be difficult to correct afterwards. For secured creditors, it provides a high degree of comfort in knowing that once it receives payment from a receivership sale, that payment is likely final and unlikely to be revisited. (This would not necessarily be the case in some bankruptcy courts.)

The case is [Bank of America, N.A. v. P.T.A. Realty, LLC](#) (R.I. Feb. 19, 2016) available [here](#).

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