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Lifting the Automatic Stay after Foreclosures in New York

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Introduction

The filing of a bankruptcy petition under title 11 of the United States Code (the "Bankruptcy Code") results in an automatic stay that bars collection efforts against a debtor's property.[1] Consequently, a creditor will generally be prevented from foreclosing on property in which a debtor has an interest, including a possessory interest. Section 362(d), however, provides that the automatic stay may be lifted or modified under four alternatives.[2] This article will discuss the implication of the automatic stay on a New York foreclosure action and bankruptcy courts' rationale for lifting the automatic stay in the foreclosure context.

Part I of the memo explains the necessary parties in a foreclosure action. Part II briefly describes the implication of a bankruptcy filing on a foreclosure. Lastly, Part III summarizes the situations in which a court may lift the automatic stay to allow a creditor to proceed with a foreclosure action.

I. Necessary Parties in New York Foreclosure Actions.

Foreclosure actions are actions to recover property that was attached by a lien to a loan. In New York State, foreclosure actions must be brought in court. The foreclosing party, typically a

[1] 11 U.S.C. § 362 (2018).
[2] *Id.* at § 362(d).

bank or credit union, will be the plaintiff in the foreclosure proceeding. In a residential foreclosure, the plaintiff must name defendants and serve a complaint on them to satisfy the notice requirement.[3] Every person having an interest in the property at stake in the foreclosure action is a "necessary defendant" under New York law.[4] As a result, both owners and tenants are necessary parties and shall be named as defendants in a foreclosure action. Defendants are afforded the ability to plead their case and raise defenses against the foreclosing party.

II. Initial Effects of a Debtor Filing for Bankruptcy on Foreclosure Proceedings.

Foreclosure proceedings are creditor actions that affect the property interest of a debtor. Thus, the automatic stay would preclude a creditor from foreclosing when that debtor files for bankruptcy.[5] The stay applies retroactively and therefore even if the foreclosure action commenced before the debtor filed for bankruptcy, the creditor cannot continue the foreclosure.[6] The automatic stay applies when the debtor is named as a defendant in the foreclosure as the owner of the property. This represents a creditor action against the property of the debtor. Moreover, New York creditors may not carry out a foreclosure sale against a debtor without violating the automatic stay even if the debtor is only a tenant in the foreclosing property.[7] While creditor actions against a debtor and their assets will trigger a violation of the stay, the stay does not enjoin creditor actions against a nondebtor.[8]

[3] N.Y. REAL PROP. ACTS. LAW §§ 1302, 1303 (McKinney 2023).
[4] *Id.* at § 1311.
[5] 11 U.S.C. § 362(a); *See In re* Ebadi, 448 B.R. 308, 314 (Bankr. E.D.N.Y. 2011).
[6] *See In re* Ebadi, 448 B.R. at 312–13 (holding foreclosure sale held days after bankruptcy petition violated the automatic stay).
[7] Bayview Loan Servicing LLC v. Fogarty (*In re* Fogarty), 39 F.4th 62, 68 (2d Cir. 2022).
[8] *See* Brown v. Jevic, 575 F.3d 322, 328 (3d Cir. 2009).

III. Methods of Lifting the Automatic Stay Afforded to Foreclosing Creditors.

Section 362(d) provides four alternatives pursuant to which a court may lift the stay to allow a creditor to enforce its rights against a debtor's assets.[9] The decision to lift the stay is at the discretion of the bankruptcy court.[10] There are specific procedures available to the creditor when applying to have the stay lifted.[11] Only a creditor that is a party in interest with a claim against the debtor or property can apply to lift the stay.[12] Particularly in foreclosure cases, courts will only allow a creditor to lift the stay if they are the holder of the note or mortgage, or an agent of the holder.[13] When there is a motion to lift the stay, the burden of proof lies with the creditor on the question of the debtor's equity.[14] The burden of proof on all other issues lies with the debtor.[15]

A. Section 362(d)(1): Lifting the stay "for cause"

Section 362(d)(1) provides that the automatic stay may be lifted "for cause."[16] Bankruptcy courts have determined multiple ways, both general and specific, in which "cause" may be found to lift the stay in foreclosure cases.[17] The two most common forms of cause employed by bankruptcy courts are bad faith and lack of adequate protection.

The first form of cause that will allow a creditor to lift the stay is if the debtor commenced the bankruptcy in bad faith. Courts are generally reluctant to lift the stay for bad faith because they do not want to deny a debtor their right to bankruptcy protection.[18] There are four factors that are often considered to constitute bad faith: "(1) a perceived improper impact on

[9] 11 U.S.C. § 362(d).
[10] *Id.*
[11] *See* 11 U.S.C. § 362(e).
[12] 3 COLLIER ON BANKRUPTCY, ¶ 362.07[2] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2023).
[13] *Id.*
[14] 11 U.S.C. § 362(g)(1).
[15] *Id.* at § 362(g)(2).
[16] *See* 11 U.S.C. § 362(d)(1).
[17] *See* 3 COLLIER ON BANKRUPTCY, ¶ 362.07[3].
[18] *See In re* 234-6 W. 22nd St. Corp., 214 B.R. 751, 757 (Bankr. S.D.N.Y. 1997).

nonbankruptcy rights; (2) a recent transfer of assets, i.e., "the new debtor syndrome" cases; (3) an inability to reorganize; and (4) unnecessary delay, i.e., serial filings."[19] The first factor is common in foreclosure cases where the debtor filed for bankruptcy to prevent the mortgage holder's remedy of foreclosure on the property.[20] The "new debtor syndrome" occurs and creates a showing of bad faith when there is a recent transfer of property with no other assets and a recent bankruptcy filing, among other characteristics.[21]

Courts have lifted the stay for bad faith in foreclosure cases when (1) the debtor's only significant asset is the property being foreclosed; (2) the foreclosing secured creditor represents the vast majority of the claim against the debtor; (3) the timing of the bankruptcy indicates a motive to disrupt the foreclosure; (4) the debtor has little to no cash flow; and finally (5) the debtor has no employees or other persons that depend on them.[22] Courts also caution that these factors should not apply "mechanically."[23] Bad faith must be determined on a "case-by-case basis" and the factors are to "assist the exercise of discretion".[24]

The second form of cause considered for lifting the stay is a lack of adequate protection of the mortgage holder's interest. Although adequate protection is not explicitly defined in the Bankruptcy Code, section 361 provides examples of when a debtor can satisfy adequate protection.[25] Section 361 lists periodic payments, additional or replacement liens, and "such other relief" that will equate to the holder's interest.[26] These examples are not exhaustive.

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[19] 3 COLLIER ON BANKRUPTCY, ¶ 362.07[7][a].
[20] *See In re* Kaplan Breslaw Ash, LLC, 264 B.R. 309, 335 (Bankr. S.D.N.Y. 2001).
[21] *See* BANKRUPTCY CASE GUIDE § 8:27 (WestLaw 2023) (listing seven characteristics that indicate a showing of bad faith due to the "new debtor syndrome").
[22] *See In re* Syndicom Corp., 268 B.R. 26, 50–52 (Bankr. S.D.N.Y. 2001) (finding numerous factors for bad faith bankruptcy to lift the stay including those listed above and more); C-TC 9th Ave. P'ship v. Norton Co. (*In re* C-TC 9th Ave. P'ship), 113 F.3d 1304, 1311 (2d Cir. 1997) (listing the factors deployed by *In re Syndicom Corp.*).
[23] *In re* 68 W. 127 St., LLC, 285 B.R. 838, 844 (Bankr. S.D.N.Y. 2002).
[24] *Id.*
[25] 11 U.S.C. §§ 361(1)–(3).
[26] *Id.*

Another form of adequate protection is the equity cushion.[27] The creditor will have an equity cushion when the value of the collateral they can collect comfortably exceeds the creditor's claim itself.[28] This can occur even when the debtor does not have equity in the property if there are junior lienholders.[29]

The overall standard for adequate protection is whether the value of the holder's interest in the foreclosing property has been maintained after the bankruptcy petition. Inadequate protection can be established by calculating the decrease in the property's monetary value caused by the debtor's failure to maintain the property following the stay. "[D]emonstrating that the debtor has completely failed, or substantially failed, to make post-petition payments" can also prove a lack of adequate protection.[30]

Courts provide a host of reasons for lifting the automatic stay for a lack of adequate protection. These include the debtor's lack of payments on mortgages for over a year, the debtor's failure to pay real estate taxes, the debtor's lack of insurance on the property, and the debtor's failure to collect rent from the tenant of the property.[31]

A. *Section 362(d)(2): Lifting the Stay for Lack of Equity in Property Unnecessary to Effective Reorganization.*

Section 362(d)(2) states that the automatic stay may be lifted when two factors are met.[32] First, the creditor must show the debtor lacks equity in the property at stake.[33] Second, the

[27] 3 COLLIER ON BANKRUPTCY, ¶ 362.07[3][d][i].
[28] *Id.*
[29] *Id.*
[30] *In re* Elmira Litho, Inc., 174 B.R. 892, 903 (Bankr. S.D.N.Y. 1994).
[31] *See In re* Kaplan Breslaw Ash, LLC, 264 B.R. 309, 332 (Bankr. S.D.N.Y. 2001); *In re* Everton Aloysius Sterling, 543 B.R. 385, 392–94 (Bankr. S.D.N.Y. 2015) (holding a lack of adequate protection satisfied cause to lift the stay when the debtor failed to make post-petition payments to creditor and pay real estate taxes on the property).
[32] 11 U.S.C. § 362(d)(2).
[33] *Id.*

property at stake must not be necessary for the debtor to carry out an effective reorganization.[34] If both factors are satisfied, the court must lift the automatic stay.[35]

A debtor has no equity in the property when the value of the liens on the property surpasses the property's value.[36] "A secured creditor seeking relief from the stay under section 362(d)(2) must show (1) the amount of its claim; (2) that its claim is secured by a valid, perfected lien in property of the estate; and (3) that the debtor lacks equity in the property."[37] The court will then determine whether the debtor has equity in the property.[38]

For a debtor to satisfy the "necessary" prong of 362(d)(2), the property must not only be necessary for a reorganization, but "necessary for an *effective* reorganization."[39] The standard is therefore not the property's necessity for debtor's reorganization but instead whether debtor's reorganization is feasible in a reasonable amount of time.[40] This determination will often be fact-intensive and depend upon the circumstances surrounding the debtor's plan in the present case.[41]

One foreclosure case determined that the property was not necessary to a debtor's reorganization plan when the debtor had no proof for its contention that the building could be "razed and replaced with condominiums."[42] On appeal, the debtor made new contentions about refinancing and an offer for the property that could be used in the reorganization plan.[43] The

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[34] *Id.*
[35] *Id.*
[36] 3 COLLIER ON BANKRUPTCY, ¶ 362.07[4] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2023).
[37] *In re* Kaplan Breslaw Ash, LLC, 264 B.R. 309, 322 (Bankr. S.D.N.Y. 2001).
[38] *Id.*
[39] 3 COLLIER ON BANKRUPTCY, ¶ 362.07[4][b] (emphasis in original).
[40] *Id.*
[41] *See In re* Kaplan Breslaw Ash, LLC, 264 B.R. at 331–32 (holding debtor's plan failed to address numerous critical Chapter 11 reorganization issues and was therefore not feasible).
[42] *In re* New Era Co., 125 B.R. 725, 730 (S.D.N.Y. 1991), *aff'g In re* New Era Co., 115 B.R. 41 (Bankr. S.D.N.Y. 1990).
[43] *Id.*

court rejected these contentions because there was no documentary evidence to support them and affirmed the bankruptcy court's decision to lift the stay for the foreclosure.[44]

Another foreclosure case determined that the debtor's property was not necessary to the reorganization plan and the plan itself was not likely to be successful in a reasonable amount of time.[45] The court discussed the challenges that the proposed plan faced under Chapter 11 of the Bankruptcy Code.[46] The court also expressed doubt that the person tasked with funding the reorganization plan could provide the necessary funding.[47] The court concluded that the debtor failed to prove that the property was "essential" to a reorganization plan that has a realistic chance of being confirmed in a reasonable amount of time.[48] As a result of this and lack of equity, the court lifted the stay under section 362(d)(2).[49]

B. *Section 362(d)(3): Single Asset Real Estate Cases*

Section 362(d)(3) of the Bankruptcy Code allows courts to lift the stay in certain single asset real estate cases.[50] 362(d)(3) provides mortgage holders a remedy in court to lift the stay when debtors file for bankruptcy primarily to delay foreclosure proceedings.[51] Under 362(d)(3), a debtor can only prevent the stay from being lifted if they take certain measures to protect the interest of the mortgage holder in a specific amount of time.[52] These measures can include

[44] *Id.*
[45] *In re* Kaplan Breslaw Ash, LLC, 264 B.R. at 331–32.
[46] *Id.* at 331 (demonstrating the plan failed to address four key issues required by the Bankruptcy Code).
[47] *Id.* at 331–32.
[48] *Id.* at 332.
[49] *Id.* at 336.
[50] 11 U.S.C. § 362(d)(3); *See* 3 COLLIER ON BANKRUPTCY, ¶ 362.07[5] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2023).
[51] *Id*.
[52] *See* 11 U.S.C. § 362(d)(3).

periodic payments, similar to adequate protection, and having a viable and effective reorganization plan in place, similar to section 362(d)(2)(b).[53]

Section 362(d)(3) single asset real estate cases differ from section 362(d)(2) in two meaningful ways.[54] First, there is no need to show lack of equity to lift the stay.[55] Second, a single asset debtor must prove not only that there is a reasonable possibility of effective reorganization but that there is an already filed plan of reorganization with a reasonable possibility of being confirmed in a reasonable amount of time.[56] Section 362(d)(3) speeds up the timeframe for debtors significantly because debtors must prove they have a plan with a reasonable possibility of being confirmed thirty days before the expiration of the exclusivity period.[57] Therefore, the time constraint placed on single asset debtors is greater than that of debtors challenging section 362(d)(2) motions to lift the stay.

In one foreclosure case, the court lifted the stay under section 362(d)(3) because the reorganization plan proposed was not feasible.[58] The plan in the case called for significant monthly payments and annual lump sum payments to creditors.[59] Considering the debtor had earned no income since filing for bankruptcy and the debtor's plan relied on purely hypothetical projections of revenue from investments and refinancing, the court did not find the plan feasible.[60] As a result, the court lifted the stay.[61]

C. *Section 362(d)(4): In rem Stay Relief*

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[53] *Id.*; *see also In re* RYYZ, LLC, 490 B.R. 29, 35–36 (Bankr. E.D.N.Y. 2013) (explaining the similarities between section 362(d)(2)(b) and 362(d)(3)).
[54] *In re* RYYZ, LLC, 490 B.R. at 36.
[55] *Id.*
[56] *Id.*
[57] *Id.*
[58] *In re* 231 Fourth Ave. Lyceum, LLC, 506 B.R. 196, 203–206 (Bankr. E.D.N.Y. 2014).
[59] *Id.* at 203.
[60] *Id.* at 203–204. ("The Debtor cannot establish a reasonable possibility of confirming a plan based on the *possibility* of investments or refinancing.").
[61] *Id.* at 199.

Section 362(d)(4) provides an *in rem* method of relief for creditors in conjunction with section 362(b)(20) of the Bankruptcy Code.[62] Section 362(b)(20) provides in relevant part that the stay does not apply against "any act to enforce any lien against or security interest in real property" for two years after a section 362(d)(4) judgment.[63] Courts will grant motions to lift the stay under 362(d)(4) when they determine the debtor petitioned for bankruptcy as part of a "scheme to delay, hinder, or defraud creditors" by either: (A) transferring their property interest without the consent of the creditor or (B) filing for bankruptcy multiple times to affect the creditor's interest in the property.[64] If the court determines that the debtor did scheme to delay, hinder, or defraud the foreclosing creditor, the court will grant *in rem* relief from the stay. As a result, the timeline is faster in these cases. The stay will only continue for thirty days after a section 362(d)(4) ruling from a court unless the court provides a different timeline.[65]

One section 362(d)(4)(B) case involved debtors who used six strategically filed Chapter 13 bankruptcy petitions to disrupt foreclosure proceedings against the property.[66] The court lifted the stay because of the serial filings and the fact that the debtors showed no willingness to reorganize and instead defrauded the creditor, claiming a false landlord-tenant relationship.[67]

Another case did not find that the debtor used a scheme to hinder, delay or defraud the foreclosure when the transfer of property occurred "almost a year" before the bankruptcy petition.[68] This transfer was not close enough to the bankruptcy petition to grant *in rem* relief for

[62] 11 U.S.C. § 362(d)(4); 11 U.S.C. § 362(b)(20).
[63] 11 U.S.C. § 362(b)(20); *see also* 11 U.S.C. § 362(d)(4).
[64] 11 U.S.C. § 362(d)(4).
[65] *Id.*
[66] *In re* Montalvo, 416 B.R. 381, 387 (Bankr. E.D.N.Y. 2009).
[67] *Id.*
[68] *In re* Everton Aloysius Sterling, 543 B.R. 385, 395 (Bankr. S.D.N.Y. 2015).

fraudulent disruption of foreclosure.[69] The court reasoned that "fraud cannot simply be inferred from the fact that a transfer took place."[70]

Conclusion

The automatic stay resulting from the filing of a petition for relief under the Bankruptcy Code provides a debtor with protection from collection efforts by creditors, including foreclosure on the debtor's property. However, under certain circumstances, a court may lift or modify the automatic stay to allow a creditor to proceed with a foreclosure action. These circumstances are: (1) cause, including bad faith bankruptcy filing and lack of adequate protection; (2) lack of equity and property unnecessary for reasonable reorganization; (3) single asset real estate that is not adequately protected or unnecessary for reasonable reorganization; and (4) a bankruptcy filing that was part of a scheme to hinder, delay or defraud creditor action.

[69] *Id.*
[70] *Id.*