# The Effects of Bankruptcy on Foreclosure

by Andrew R. Wilson[1]

## I. Introduction

Bankruptcy is frequently used to stop foreclosure sales. This article provides an overview of the effects of a bankruptcy petition on a foreclosure action and steps creditors can take to obtain possession of the property or otherwise protect their client's interests.

## II. Modern Bankruptcy Laws

The word "bankruptcy" is derived from the Latin word "banca rotta," which means "broken [merchant's] bench."[2] In medieval days, when a merchant was insolvent and could not pay his creditors, his stand or bench was broken. Modern bankruptcy laws prevent such remedies. Today, bankruptcy is used by debtors to discharge themselves of debts and to make a fresh start in life with little to no monetary obligations.

The purpose of bankruptcy is twofold. As a debtor's remedy, bankruptcy provides the honest but unfortunate debtor with a fresh start in the debtor's finances by discharging the debtor's past debts and freeing future income from the claims of creditors. As a creditor's remedy, bankruptcy marshals the debtor's nonexempt assets and distributes them on a pro-rata basis to creditors in order of priority.

Article 1, Section 8, Clause 4 of the United States Constitution authorizes Congress to enact "uniform Laws on the subject of Bankruptcies throughout the United States."[3] Congress has exercised this authority several times, most recently by adopting the Bankruptcy Reform Act of 1978, codified in Title 11 of the United States Code and commonly referred to as the "Code" or the "Bankruptcy Code."[4] The Bankruptcy Code has been amended several times since 1978, including the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 or "BAPCPA" and the Small Business Reorganization Act of 2019, which added a new

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[2] THOMAS J. SALERNO ET AL., BANKRUPTCY LITIGATION AND PRACTICE § 1.1 (1st ed. 1995)
[3] U.S. CONST. art. 1, § 8, cl. 4.
[4] 11 U.S.C. §§ 101-1532 (2006).

subchapter V to chapter 11 aimed at reducing the costs and increasing the speed of bankruptcy for small business and individuals.

The Bankruptcy Code is augmented by the Federal Rules of Bankruptcy Procedure (Bankruptcy Rules); decisions of United States Bankruptcy Courts, Federal District Courts, and the United States Supreme Court; and by state and local laws.

## III. The Bankruptcy Code

The Bankruptcy Code is comprised of nine "chapters." Chapters 1, 3, and 5 are general provisions that apply to all bankruptcy proceedings unless a provision specifically provides otherwise. Chapters 7, 9, 11, 12, 13, and 15 are the substantive bankruptcy chapters, each of which governs a different type of bankruptcy proceeding.

An individual will generally choose Chapter 7 or Chapter 13. A business can file either a Chapter 7 or a Chapter 11 petition. The kind of bankruptcy petition the debtor chooses to file depends on the goals of the person filing the petition.

### *A. Administrative Chapters*

Chapter 1 contains a number of general provisions, including the definitions, rules of construction, general powers of the bankruptcy court, and the eligibility requirements of debtors for each of the different types of available bankruptcy proceedings.[5]

Chapter 3 governs case administration.[6] Sections 301 through 307 outline how to commence a bankruptcy case.[7] Sections 321 though 331 set forth rules governing those who administer the bankruptcy estate.[8] And section 362 contains the all-important "automatic stay" provision, which prohibits creditors' attempts to continue to collect prepetition debts from the debtor or the debtor's property after the filing of the bankruptcy petition.[9]

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[5] 11 U.S.C. § 101-112.
[6] 11 U.S.C. §§ 301-366.
[7] 11 U.S.C. §§ 301-307. For example, section 301 provides that a voluntary case commences when the person files a petition with the bankruptcy court. Section 303(a) provides that an involuntary case may only be commenced under Chapter 7 or Chapter 11 against a person, not a farmer or non-profit corporation. Additionally, section 303(b) places restrictions on who may file the involuntary petition under Chapters 7 and 11.
[8] 11 U.S.C. §§ 321-331.
[9] 11 U.S.C. § 362.

Chapter 5 describes how creditors' claims against the debtor are handled, the rights and duties of the debtor, and the trustee's power to distribute assets.[10]

### *B. Chapter 7 Liquidation*

Chapter 7 governs the classic "straight" liquidation bankruptcy. Chapter 7 is available only to eligible individuals and businesses.[11] Normally, the entire administration of the bankruptcy estate under Chapter 7 is left to the court-appointed Chapter 7 Panel Trustee.[12] A list of the acting Chapter 7 Trustees in Mississippi may be found on the Bankruptcy Court websites for the Northern and Southern Districts of Mississippi. The trustee collects all of the debtor's nonexempt assets that existed on the date the petition was filed, liquidates those assets, and distributes the proceeds to the creditors on a pro-rata basis.[13] At the end of the process, the debtor receives a discharge of nearly all prepetition obligations.[14] Unlike an individual, however, a corporation or other entity that files under Chapter 7 does not receive a discharge of its prepetition obligations at the end of the case because the purpose of a corporation filing under Chapter 7 is to assure creditors that the corporation has no assets available for distribution to unsecured creditors.[15]

### *C. Chapter 9 Municipal Reorganization*

Chapter 9 contains special provisions for the adjustment of debts of a financially distressed municipality or other governmental entity.[16] The purpose of Chapter 9 is to allow the municipality to continue operating while it adjusts or refinances creditor claims with minimum

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[10] 11 U.S.C. §§ 501-562.

[11] 11 U.S.C. §§ 109(b) and 707(b). Under BAPCPA, Congress increased the scrutiny of individual debtors to see which ones should be denied access to Chapter 7 because they are abusing the system. Congress exempted anyone whose debts are mostly business related from any screening for abuse. The test for eligibility in Chapter 7 is complex. Under section 707(b)(1), the court may dismiss a case or convert it to Chapter 13 or Chapter 11 if the Chapter 7 filing constitutes "abuse." There are two ways to determine whether an individual debtor's filing constitutes abuse. The court shall presume abuse exists if the debtor "fails" a perplexing formula called the "means test," which, suffice it to say, consists of income minus expenses. 11 U.S.C. § 707(b)(2). But, even if the debtor "passes" the means test, the court may still find abuse if the debtor filed the case in "bad faith," or if "the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse." 11 U.S.C. § 707(b)(3).

[12] 11 U.S.C. §§ 704.

[13] Id.

[14] 11 U.S.C. § 727.

[15] 11 U.S.C. § 727(a)(1).

[16] 11 U.S.C. §§ 901-946.

loss to its creditors.[17] In 2013, the city of Detroit, Michigan, filed for Chapter 9 bankruptcy. It is the largest municipal bankruptcy in U.S. history with debts of about $20 billion. The previous largest municipal bankruptcy was that of Jefferson County, Alabama, in 2011, with debts of about $4 billion.

### *D. Chapter 11 Reorganization*

Chapter 11 is the chapter most often used by reorganizing businesses, although it may be used by individuals as well.[18] The primary purpose of Chapter 11 is to "prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources."[19] It generally deals with the reorganization of a financially distressed business enterprise, providing for its rehabilitation by adjustment of its debt obligations and equity interests.[20] The largest Chapter 11 bankruptcy in history was Lehman Brothers Holdings Inc. in 2008. It had total assets of $691 billion. The third largest Chapter 11 bankruptcy was filed by Worldcom Inc., which was headquartered in Clinton, Mississippi.

In Chapter 11, a trustee is not automatically appointed by the court. Instead, the debtor typically administers the estate and is known as the "debtor in possession," or DIP.[21] The DIP has most of the rights, duties, and powers of a Chapter 11 trustee, including the power to operate its business.[22]

Chapter 11 generally culminates in the confirmation of a plan of reorganization. One of the debtor's most important rights in Chapter 11 is the exclusive right to propose a plan of reorganization during the initial 120 days after filing the bankruptcy petition.[23] If the debtor does not propose a plan within 120 days of filing the petition, and the court does not grant an

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[17] H.R. Rep. No. 595, 95th Cong., 1st Sess., at 262-64 (1977).
[18] 11 U.S.C. §§ 109(d).
[19] NLRB v. Bildisco & Bildisco, 465 U.S. 513, 528 (1983).
[20] S. Rep. No. 989, 95th Cong., 2d Sess., at 9-12 (1978).
[21] 11 U.S.C. §§ 1103-1104, 1107-1108.
[22] 11 U.S.C. § 1107(a). For example, the debtor in possession does not have the right to compensation, which is normally awarded to a trustee under section 330. And the debtor in possession does not have to perform those duties proscribed in section 1106(a)(2)(4).
[23] 11 U.S.C. § 1121(a)-(b).

extension, the creditors may propose a plan.[24] Regardless of who files the plan, it must be confirmed by the court.[25]

A plan of reorganization divides the claims of the creditors into various classes and proposes a treatment for each class.[26] After the debtor files the plan, the debtor must try to get the plan accepted by each class of claims. A fully consensual plan will normally be confirmed.[27] Yet, under certain circumstances, a plan may be "crammed down" over the objection of non-consenting classes.[28]

Oftentimes, rather than attempt a reorganization, many businesses have conducted so-called liquidating Chapter 11's, selling substantially all of their assets under § 363 of the Bankruptcy Code and then distributing the proceeds to creditors, either through a plan of reorganization, or upon conversion of the case to a Chapter 7.

While Chapter 11 can be much more time consuming and expensive than Chapter 7, Chapter 11 is an important business tool and can provide a constructive solution to a business's financial problems.

### *E. Subchapter V of Chapter 11*

The Small Business Reorganization Act of 2019 was signed into law on August 23, 2019, and took effect on February 1, 2020. The Act added a new subchapter V to Chapter 11, 11 U.S.C. §§ 1181-1195, which is aimed at reducing the costs and increasing the speed of bankruptcy for small businesses and individuals. The Act is designed to fill a gap in the current bankruptcy laws by providing a framework for small businesses and individuals to successfully reorganize in bankruptcy. Chapter 11 was designed for administering complex business reorganizations. While there are several provisions specifically geared toward small businesses, research shows that navigating Chapter 11 successfully remains difficult for small businesses, including high costs

[24] 11 U.S.C. § 1121(b)-(c).
[25] 11 U.S.C. § 1129.
[26] 11 U.S.C. § 1122. "[A] plan shall (1) designate … classes of claims … and classes of interests …." 11 U.S.C. § 1123(a)(1). "[A] plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class." 11 U.S.C. § 1122(a).
[27] 11 U.S.C. §§ 1126, 1129.
[28] 11 U.S.C. § 1129(b).

and procedural hurdles. Consequently, small businesses, overwhelmed with the burdens of Chapter 11, frequently cannot craft successful plans and are forced to liquidate after filing for bankruptcy. Chapter 13 bankruptcy is not a viable alternative either for a business or for individuals with high debts. Chapter 13 is available only to individuals with unsecured debts of less than $526,700 and secured debts of less than $1,580,125, as discussed below.

Here are several of the key provisions of subchapter V of Chapter 11, many of which take their cue from Chapter 13:

*Eligibility.* Subchapter V is generally available to both individuals and businesses engaged in commercial or business activities that has aggregate debts of not more than $3,424,000 not less than 50% of which arose from the commercial or business activities of the debtor.[29] A single-asset-real-estate debtor is ineligible for subchapter V.

*Debtors Must Opt-In.* Subchapter V is voluntary. A debtor who wishes to use it must check the appropriate box on his bankruptcy petition. Proceedings using the current Chapter 11 provisions will continue to be called 'small business cases,' while cases for which the new subchapter V is elected will be called "cases under subchapter V of chapter 11."

*No Committees.* No unsecured creditors or other committees are appointed except for cause.

*No Disclosure Statement.* No disclosure statement is required except for cause.

*Plan Proposal.* Under a "legacy" Chapter 11, a small business debtor has the exclusive right to file a plan during the first 180 days of the case and must file a plan within the first 300 days of the case to avoid dismissal, and after filing the plan, the debtor has 45 days to obtain confirmation, unless extended by the court. Under subchapter V, *only* the debtor may file a plan, and it must be filed within 90 days of the commencement of the case, unless extended by the court for cause.

*Plan Confirmation.* Subchapter V incorporates most of the conditions for consensual confirmation but contains two key differences for cramdown plans. First, small business debtors

[29] 11 U.S.C. §§ 101(51D) and 1182.

are no longer required to have an accepting impaired class to confirm a cramdown plan. Instead, the plan need only (a) not discriminate unfairly and (b) be fair and equitable with respect to impaired classes. Second, there is **no absolute-priority rule**. The owner of the small business may retain a stake in the company without paying higher-priority classes in full as long as the plan (a) does not unfairly discriminate and (b) is fair and equitable with respect to each class of claims or interests. To be "fair and equitable" requires the debtor to devote its disposable income or the value of its disposable income to payments over the life of the plan (three to five years) and includes a feasibility concept, requiring that the debtor has at least a reasonable likelihood that it will be able to make the payments under the plan.

*Subchapter V Trustee.* A trustee will be appointed in every case as a matter of course, similar to Chapter 13, whose duties will include: (a) appearing and being heard regarding the value of property subject to a lien, confirmation or modification of the plan, or sale of property of the estate; (b) facilitating the development of a consensual plan; (c) ensuring the debtor commences making timely payments required by a plan; (e) examining and potentially objecting to proofs of claim; and (f) opposing the debtor's discharge, if advisable.'

*Initial Status Conference.* An initial status conference is held in every case within 60 days of commencement "to further the expeditious and economical resolution" of a subchapter V case.

*Administrative Expenses.* Administrative expenses may be paid over the life of the plan.

*Debtor's Principal Residence.* A plan may propose to modify the rights of the holder of a claim secured by the debtor's principal residence if the debt was used primarily in the debtor's business (e.g., a home equity line of credit).

*Discharge.* If a consensual plan is confirmed, the debtor will receive a discharge upon plan confirmation. If the plan is confirmed via cramdown, the debtor will not receive a discharge until after all plan payments are made over a three to five-year period.

### *F. Chapter 12 Family Farmer Reorganization*

Chapter 12 governs reorganization bankruptcies filed by family farmers or fishermen.[30]

[30] 11 U.S.C. §§ 1201-1231.

Only family farmers[31] with farming debts below $12,562,250 and regular annual income derived to a certain extent from farming operations qualify for filing under Chapter 12.[32] The goal of Chapter 12 is to give family farmers the ability to keep their farms even when they owe a secured creditor more than the market value of the farms, while simultaneously ensuring that the secured creditors' property interests are protected.

### *G. Chapter 13 Wage Earner Proceeding*

Chapter 13, which excludes corporations, is frequently used by reorganizing individuals. It allows individual debtors with a regular income to make payments to creditors over time.[33] It provides a highly effective means of resolving the debt problems of many individual debtors, often resulting in minimal payments to unsecured creditors. Eligibility is restricted to individuals with unsecured debts of less than $526,700 and secured debts of less than $1,580,125.[34] Only a voluntary petition for this type of bankruptcy is allowed.[35]

A panel trustee is appointed to supervise and distribute the payments of the debtor under the plan.[36] Unlike Chapter 11, only the debtor can propose the Chapter 13 plan.[37] The debtor generally creates a plan that restructures the payment of debts over a period of three years, subject to a five-year extension.[38] If the plan meets the requirements prescribed by statute, the court will confirm the plan.[39]

## IV. The Order for Relief

Regardless of the chapter under which relief is sought, the filing of a voluntary or joint bankruptcy petition constitutes an order for relief under that chapter.[40] And the instant the order

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[31] 11 U.S.C. § 101(18).
[32] 11 U.S.C. § 109(f).
[33] 11 U.S.C. §§ 1301-1330.
[34] 11 U.S.C. § 109(e). The debt limits are adjusted every three years pursuant to section 104 to reflect the change in the Consumer Price Index.
[35] See 11 U.S.C. § 303(a).
[36] 11 U.S.C. § 1302. The trustee's duties in a non-business related Chapter 13 case are outlined in section 1302(b)(1)-(5). If the Chapter 13 debtor is engaged in business activities, then the trustee has additional duties as set forth in section 1302(c).
[37] 11 U.S.C. § 1321.
[38] 11 U.S.C. § 1322(d).
[39] 11 U.S.C. § 1325.
[40] 11 U.S.C. §§ 301, 302(a), 303(h). When an involuntary case is commenced under Chapter 7 or Chapter 11, the

for relief is entered, a bankruptcy estate is created[41] and all collection efforts against the debtor and the bankruptcy estate must cease pursuant to section 362(a).[42] A bankruptcy estate, or "property of the estate," is comprised of all legal and equitable interests of the debtor in property, wherever located, as of the moment the case was filed.[43]

Importantly, the filing of the bankruptcy petition operates as a stay on all collection efforts against the debtor and the debtor's bankruptcy estate.[44]

## V. The Automatic Stay

### *A. Overview and Purposes*

The momen a bankruptcy petition is filed, section 362(a) of the Bankruptcy Code imposes an automatic stay of all prepetition collection activities—including a scheduled foreclosure sale—against the debtor and the debtor's estate.[45] The stay is automatic immediately upon the filing of the bankruptcy petition; no notice is required for the stay to take effect.[46] It operates as a self-executing injunction preventing creditors from taking any collection actions against the debtor or the debtor's bankruptcy estate for prepetition obligations.[47]

The automatic stay is one of the fundamental debtor protections under the Bankruptcy Code. The stay provides the debtor with a breathing spell by stopping all collection efforts, harassment, and all foreclosure actions.[48] The automatic stay provides creditor protection as well by preventing creditors from pursuing their own remedies against the debtor and the debtor's property. It preserves the status quo while the debtor's affairs are sorted out and ensures the orderly distribution of the debtor's nonexempt assets by temporarily protecting the debtor's

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bankruptcy court must actually enter the order for relief. Id.

[41] 11 U.S.C. § 541(a).

[42] 11 U.S.C. § 362(a).

[43] 11 U.S.C. § 541(a).

[44] § 362(a). The automatic stay does not apply to claims that arise postpetition. See Id.; see also Campbell v. Countrywide Home Loans, Inc., 545 F.3d 348, 353 (5th Cir. 2008).

[45] Id. The automatic stay does not apply to claims that arise postpetition. Id.; Campbell v. Countrywide Home Loans, Inc., 545 F.3d 348, 353 (5th Cir. 2008).

[46] 11 U.S.C. § 362(a); Rexnord Holding, Inc. v. Bidermann, 21 F.3d 522, 527 (2d Cir. 1994).

[47] 11 U.S.C. § 362; Campbell, 545 F.3d at 353. See also In re Johnson, 478 B.R. 235, 246 (Bankr. S.D. Miss. 2012).

[48] See Reliant Energy Servs. Inc. v. Enron Canada Corp., 349 F.3d 816, 825 (5th Cir. 2003).

property from the reach of creditors.[49]

### *B. Scope of the Stay*

The scope of the automatic stay is extremely broad. The stay applies to all actions against the debtor and property of the bankruptcy estate.[50] Conducting a postpetition foreclosure sale of the debtor's property is a clear violation of the automatic stay.[51]

Of course, the stay is *not* applicable to actions not directed against the debtor or property of the debtor.[52] For example, if a lender completes a foreclosure sale before the bankruptcy case is filed, neither the debtor nor the estate has any interest in the property, and thus the stay does not apply.[53]

In Chapter 12 and Chapter 13 cases, the automatic stay applies to codebtors, too.[54] A creditor of a Chapter 12 or Chapter 13 debtor may not attempt to collect a consumer debt[55] of the debtor from any person that is liable on the debt with the debtor, or that secured the debt, unless that person became liable on or secured the debt in the ordinary course of business.[56] On the request of a party in interest, the court may grant a creditor relief from the codebtor stay (in addition to the "regular" stay) if (1) the codebtor received the consideration for the creditor's claim against the debtor; (2) the plan proposes not to pay the creditor's claim; or (3) the creditors interest would be irreparably harmed if the codebtor stay continues.[57]

### *C. Length of the Stay*

The automatic stay is not permanent.[58] The stay generally continues, in the case of acts against property of the estate, until the property is no longer property of the estate, or in the case

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[49] Id.
[50] See 11 U.S.C. §§ 362(a), 541(a)(1); In re Chestnut, 442 F.3d 298 (5th Cir. 2005).
[51] *Jackson*, 392 B.R. at 671.
[52] In re TXNB Internal Case, 483 F.3d 292, 302 (5th Cir. 2007).
[53] See In re Theoclis, 213 B.R. 880 (Bankr. D.Mass. 1997).
[54] 11 U.S.C. §§ 1201(a), 1301(a).
[55] "Consumer debt" is debt incurred by an individual primarily for personal, family, or household purposes. 11 U.S.C. § 101(8). The automatic stay under §§ 1201(a) and 1301(a) apply only to the collection of a consumer debt.
[56] 11 U.S.C. §§ 1201(a), 1301(a). See also In re Grinstead, 2009 WL 2499610 (Bankr. S.D. Miss. Aug. 14, 2009).
[57] 11 U.S.C. §§ 1201(c), 1301(c).
[58] But a debtor's discharge "operates as an injunction" against any act "to collect, recover or offset any such debt as a personal liability of the debtor . . . ." 11 U.S.C. § 524(a). So upon the debtor receiving a discharge, the discharge injunction replaces the automatic stay. See, e.g., In re Rosteck, 899 F.2d 694, 697-98 (7th Cir. 1990).

of other acts, until the earliest of the close of the case, dismissal of the case, or at the time discharge is granted or denied.[59] The stay may also be terminated upon court order on the request of a creditor or other party in interest.[60] Requesting relief from the automatic stay is addressed below.

Notably, in an individual Chapter 7, 11, or 13 case, if the individual was a debtor in a previously dismissed case pending within the preceding year, the stay is automatically terminated within 30 days of the filing the later case.[61] This rule does not apply to a case refiled under a chapter other than Chapter 7 after dismissal of the prior Chapter 7 case under section 707(b) of the Bankruptcy Code.[62] Upon the request of a party in interest, the court will issue an order confirming the termination of the automatic stay.[63] Still, upon the motion of the debtor, the court may continue the automatic stay after notice and a hearing completed before the expiration of the 30-day period, if such party demonstrates that the later case was filed in good faith as to the creditors who are stayed by the filing.[64] A case is presumptively not filed in good faith in one of three scenarios: (1) if more than one bankruptcy case under Chapter 7, 11, or 13 was previously filed by the debtor within the preceding year; or (2) if the prior Chapter 7, 11, or 13 case was dismissed within the preceding year for the debtor's failure to (a) file or amend without substantial excuse a required document, (b) provide adequate protection ordered by the court, or (c) perform the terms of a confirmed plan; or (3) if there has been no substantial change in the debtor's financial or personal affairs since the dismissal of the prior case, or there is no reason to conclude that the pending case will conclude either with a discharge (if a Chapter 7 case) or confirmation (if a Chapter 11 or 13 case).[65] Additionally, a case is presumptively not filed in good faith as to any creditor who obtained relief from the automatic stay in the prior case, or sought such relief in the prior case and such action was pending at the time of the prior case's

[59] 11 U.S.C. § 362(a), (c); Browning v. Navarro, 743 F.2d 1069, 1083 (5th Cir. 1984).
[60] 11 U.S.C. § 362(d)-(g).
[61] 11 U.S.C. § 362(c).
[62] Id.
[63] 11 U.S.C. § 362(j).
[64] 11 U.S.C. § 362(c).
[65] Id.

dismissal.[66]

A similar presumption applies if a bankruptcy case is filed by or against an individual and if such individual was a debtor in two or more cases within the previous year, other than a case refiled under section 707(b).[67] The presumptions may be rebutted by clear and convincing evidence.[68] If a creditor believes the debtor qualifies as a serial filer under the Bankruptcy Code and that the stay therefore terminates after 30 days, it is recommended that the creditor obtain a comfort order from the bankruptcy court confirming that the belief.

### *D. Violating the Stay*

Acts taken in violation of automatic stay are voidable, not void *ab initio*, and capable of discretionary cure by the court.[69] A voidable transaction or occurrence is one that was invalid or had no legal effect when it occurred but may be made valid by subsequent judicial act.[70] For example, the bankruptcy court could annul the stay, which acts to terminate it retroactively.[71]

Under section 362(k), if a creditor willfully violates the stay, the debtor may be awarded actual damages, costs, attorney's fees, and even punitive damages.[72] A willful violation of the automatic stay occurs when a creditor, with knowledge of the stay, seizes the debtor's property without first obtaining relief from the stay from the bankruptcy court.[73] There are three elements for a claim under section 362(k): (1) creditor must have known of the existence of the stay, (2) creditor's acts must have been intentional, and (3) creditor's acts must have violated the stay.[74] When in doubt about whether the automatic stay applies, creditors should first seek relief from

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[66] Id.
[67] Id.
[68] Id.
[69] Sikes v. Global Marine, Inc., 881 F.2d 176 (5th Cir. 1989). But see Franklin Sav. Ass'n v. Office of Thrift Supervision, 31 F.3d 1020 (10th Cir. 1994) (holding that actions taken in violation of automatic stay are void and without effect); Hillis Motor, Inc. v. Hawaii Auto Readers Ass'n., 997 F.2d 581 (9th Cir. 1993).
[70] In re Pierce, 272 B.R. 198, 208 (Bankr. S.D. Tex 2001).
[71] Id. at 204.
[72] 11 U.S.C. § 362(k); see In re Chestnut, 422 F.3d 298 (5th Cir. 2005) (holding that creditor willfully violated automatic stay when it foreclosed on debtor's property knowing of debtor's bankruptcy, and even though it was later determined that property did not belong to bankruptcy estate, creditor was required to pay fine and attorney's fees, because property was arguably property of estate at time of foreclosure and bankruptcy law demands some process before seizure of property to which debtor only has arguable claim of right).
[73] Chestnut, 422 F.3d at 300.
[74] In re Repine, 536 F.3d 512 (5th Cir. 2008).

the automatic stay or a comfort order confirming the stay is not applicable. Failing to obtain an order could be costly.

### *E. Exceptions to the Stay*

Section 362(b) provides certain exceptions to the automatic stay. Actions that fall under any one of the specific exceptions are not automatically stayed upon the commencement of the case. Exceptions to the stay are narrowly interpreted.[75] Therefore, when in doubt, creditors should seek relief from the automatic stay.

For example, under section 362(b), the commencement of a foreclosure action where the mortgage on the debtor's property is insured under the National Housing Act and covers property consisting of five or more units is not enjoined by the filing of a bankruptcy petition.[76]

The stay does not apply to an act to enforce any lien against or security interest in real property within two years following the entry of an order lifting the stay entered pursuant to section 362(d)(4).[77]

The stay does not apply to an act to enforce a lien against or security interest in real property if the debtor is ineligible to be a debtor in a bankruptcy case under section 109(g), or filed the bankruptcy case in violation of an order issued in a prior bankruptcy case prohibiting the debtor from being a debtor in a subsequent bankruptcy case.[78]

Section 362(l) creates an exception to the stay to permit the recovery of possession by rental housing providers of their property in certain circumstances where a judgment for possession has been obtain against the debtor before the filing of the bankruptcy petition.[79]

Under section 362(n), the automatic stay does not apply in a Chapter 11 case where the debtor: (1) is a debtor in a small business case pending at the time the subsequent case is filed;

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[75] See Hillis Motor, 997 F.2d at 590.
[76] 11 U.S.C. § 362(b)(8).
[77] 11 U.S.C. § 362(b)(20). Section 362(d)(4) permits the court to grant a creditor whose claim is secured by an interest in real property relief from the stay, if the court finds that the filing of the bankruptcy case was part of a scheme to delay, hinder, and defraud creditors that involved either a transfer of all or part of an ownership interest in real property without such creditor's consent or without court approval, or multiple bankruptcy filing affecting the real property.
[78] 11 U.S.C. § 362(b)(21).
[79] 11 U.S.C. § 362(l).

(2) was a debtor in a small business case dismissed in the two years preceding the date the order for relief was entered in the pending case; (3) was a debtor in a small business case in which a plan was confirmed in the two years preceding the date the order for relief was entered in the pending case; or (4) is an entity that has acquired substantially all of the assets or business of a small business debtor as described above, unless such entity establishes by a preponderance of the evidence that it acquired the assets in good faith and not for the purpose of evading this provision.[80] Section 362(n) does not apply to a Chapter 11 case that is commenced involuntarily and involves no collusion between the debtor and the petitioning creditors. This section also does not apply if the debtor proves by a preponderance of the evidence that (1) the filing of the subsequent case resulted from circumstances beyond the debtor's control and not foreseeable at the time the previous case was filed and (2) that it is more likely than not that a plan of reorganization will be confirmed within a reasonable time.[81]

Notably, while the Bankruptcy Code provides exceptions to the automatic stay, the court has the power to stay any action not automatically covered by the automatic stay.[82]

## VI. Obtaining Relief from the Automatic Stay

### *A. Overview*

While the automatic stay is broad in scope, the Bankruptcy Code provides for procedural safeguards for the benefit of secured creditors. Because the automatic stay prevents secured creditors from foreclosing on their liens, the Bankruptcy Code allows the bankruptcy court to grant creditors relief from the automatic stay under certain circumstances.[83] The court may grant relief from the automatic stay by terminating, annulling, modifying, or conditioning the stay. Whether to grant relief from the stay is within the sound discretion of the bankruptcy court.[84]

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[80] 11 U.S.C. § 362(n)(1). A "small business debtor" is generally a person engaged in business activities that has aggregate noncontingent liquidated debts of $3,424,000 or less in a bankruptcy case in which an unsecured creditors committee has not been appointed. 11 U.S.C. § 101(51C).
[81] 11 U.S.C. § 362(n)(2).
[82] See, e.g., 11 U.S.C. § 105(a) (permitting court to issue any order necessary or appropriate to carry out provisions of Bankruptcy Code).
[83] See 11 U.S.C. § 362(d).
[84] See, e.g., Capital Commc'ns Fed. Credit Union v. Boodrow, 197 B.R. 409, 412 (N.D. N.Y. 1996).

Relief from the automatic stay may be accomplished by filing a motion for relief from the stay[85] with the court[86] by any creditor or a party in interest.[87] The court is then required to hold a hearing within 30 days, and if the hearing is a preliminary hearing, a final hearing must be concluded within 30 days of the preliminary hearing.[88] An extension may be granted if the parties consent or compelling circumstances exist, e.g., the court's calendar prevents it from holding a hearing within the 30-day period.[89]

The motion for relief from the automatic stay must be filed in accordance with Bankruptcy Rules 4001 and 9014 as well as Miss. Bankr. L.R. 4001-1. Unless otherwise ordered by the court, the motion is served in the manner provided for by the Bankruptcy Rule 7004.[90]

Section 362(d) allows the court to grant relief from the automatic stay (1) for "cause," including lack of adequate protection of the creditor's interest in its collateral; (2) when the debtor lacks equity in property that is not necessary to an effective reorganization; or (3) when the subject property is a single asset real estate as defined in section 101(51B) of the Bankruptcy Code.[91]

### *B. Relief for Cause*

The Bankruptcy Code does not offer guidance as to what constitutes "cause," other than it includes the lack of adequate protection of an interest in property of the party requesting relief from the stay.[92] Courts must determine whether cause exists on a case-by-case basis.[93] For example, a desire to permit an action to proceed to completion in another tribunal may provide

[85] Fed. R. Bankr. P. 4001(1)(a).
[86] When a matter is referred by the district court to the bankruptcy court, the role of the bankruptcy judge depends on whether the proceeding is core or non-core. If the matter is a core proceeding, the bankruptcy judge may hear and determine the issues and may enter appropriate orders and judgments subject to appellate review. See 28 U.S.C. §157(b)(1) (2006). Motions for relief from the automatic stay are core proceedings. 28 U.S.C. § 157(b)(2)(G). Therefore, a bankruptcy judge is entitled to rule on a motion for relief from the stay. Id.
[87] 11 U.S.C. § 362(d). Because a motion for relief is a contested matter, Fed. R. Bankr. P. 9014 states that relief is to be requested by motion and a hearing must be conducted. See also Miss. Bankr. L.R. S7-1 (applicable only in Chapter 7 cases) and Proposed Miss. Bankr. L.R. 4001-1.
[88] 11 U.S.C. § 362(e).
[89] Id.
[90] Fed. R. Bankr. P. 9014(b) and 7004(b)(9).
[91] 11 U.S.C. § 362(d).
[92] In re Reitnauer, 152 F.3d 341, 343 n.4 (5th Cir. 1998).
[93] Id.

the requisite cause.[94] Another cause might include the lack of any connection with or interference with the pending bankruptcy case.[95]

Under section 362(d)(1), upon request of a secured creditor, the court may grant relief from the automatic stay for lack of adequate protection of the secured creditor's interest in property of the debtor. Adequate protection is a concept developed to ensure that the creditor's interest in the property is protected during the pendency of the bankruptcy case.[96] The rights of the secured creditor should not be materially less at the end of the case than they were at the beginning.

The ratio of the debt owed to the value assigned to the collateral must be reviewed to determine whether there is adequate protection.[97] The Bankruptcy Code does not dictate a particular appraisal method, but rather, valuation is determined on a case-by-case basis, taking into account nature of debtor's business, market conditions, debtor's prospects for rehabilitation, and type of collateral.[98] If an "equity cushion" exists, the court may order that the "cushion" is sufficient to provide adequate protection.[99] An equity cushion is the classic form of protection for a secured debt.[100]

Once lack of adequate protection is shown by the creditor, three nonexclusive means exist by which a debtor may provide adequate protection:[101] (1) The court may require the trustee or debtor in possession to make periodic cash payments to the creditor.[102] The court would order this type of relief if the property value were depreciating at a fixed rate.[103] (2) The

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[94] Pursue Energy Corp. v. Mississippi State Tax Com'n., 338 B.R. 283, 291 (S.D. Miss. 2005) (citing H.R. Rep. No. 95-595, 95th Cong., 1st Sess., at 343-44 (1977)).
[95] Id.
[96] 11 U.S.C. § 361. Section 361, which governs the concept of adequate protection, does not apply in Chapter 12. See 11 U.S.C. § 1205(a).
[97] See 11 U.S.C. § 361.
[98] In re Sutton, 904 F.2d 327, 329 (5th Cir. 1990) (citing Stewart v. Gurley, 745 F.2d 1194 (9th Cir.1984); In re Cardell, 88 B.R. 627 (Bankr. D.N.J. 1988)).
[99] In re Conquest Offshore Intern., Inc., 73 B.R. 171 (Bankr. S.D. Miss. 1986).
[100] Id.
[101] 11 U.S.C. § 361(1)-(3).
[102] 11 U.S.C. § 361(1).
[103] Id.

trustee or debtor in possession may furnish an additional or replacement lien,[104] which provides the secured creditor with an interest in additional property of the debtor to make up for the loss.[105] (3) Or the court may "grant[] such other relief [other than the granting of an administrative expense priority] as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property."[106] For example, a principal of a corporation may offer to guaranty the solvent debtor's obligations.[107] And, of course, the debtor may always provide adequate protection by returning all or a portion of the collateral.[108]

Adequate protection does not require periodic postpetition payments for interest or lost opportunity costs to an undersecured creditor to compensate for delay of reorganization during pendency of the automatic stay.[109]

### *C. Relief for Lack of Equity*

Section 362(d)(2) provides that the court may grant relief from the automatic stay if the debtor has no equity in the subject property and the property is not necessary for an effective reorganization. This section is intended to solve the problem of real property mortgage foreclosures where the bankruptcy petition is filed on the eve of foreclosure.[110]

"Equity" means the difference between the value of the subject property and the encumbrances against it.[111] As in section 362(d)(1), the court's determination of the property's value is central to its decision whether to lift the stay pursuant to section 362(d)(2).[112] Property valuation is determined on a case-by-case basis, taking into account the nature of the debtor's business, market conditions, the debtor's prospects for rehabilitation, and the type of collateral.[113]

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[104] 11 U.S.C. § 361(2).
[105] H.R. Rep. No. 95-595, 95th Cong., 1st Sess., at 343-44 (1977).
[106] 11 U.S.C. § 362(3).
[107] 1 Thomas J. Salerno, et al., Bankruptcy Litigation and Practice § 4.94 (1995).
[108] Id.
[109] United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365 (1988).
[110] H.R. Rep. No. 595, 95th Cong., 1st Sess., at 343-44 (1977).
[111] Sutton, 904 F.2d at 329.
[112] Id.
[113] Id. (citing 2 Collier on Bankruptcy ¶ 361.02 (15th ed. 1990); H.R. Rep. No. 595, 95th Cong., 2d Sess., at 339, reprinted in 1978 U.S. Code Cong. & Admin. News 5787, 6295); In re Conquest Offshore Int'l, Inc., 73 B.R. 171 (Bankr. S.D. Miss. 1986).

### *D. Relief with Respect to SARE Debtor*

Pursuant to section 362(d)(3), the court shall grant relief from the automatic stay with respect to an act against a single asset real estate[114] (SARE) debtor, upon the request of a creditor whose claim is secured by an interest in such real estate, unless within the later of 90 days after the order for relief (or within a later date as the court may determine for cause by order entered within the initial 90-day period) or 30 days after the court determines that the debtor is a SARE debtor, the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time, or the debtor is making monthly payments to the creditor from income generated from the property that is equal to interest at the non-default contract rate on the value of the creditor's interest in the property.[115]

SARE debtors are carved out and subjected to stringent requirements under section 362(d)(3), which expedites the time for SARE debtors to either file a plan or commence making monthly payments, or else the automatic stay is promptly lifted.[116] So the class of debtors that qualify as SAREs is extremely limited.[117] Thus, the key to a creditor's ability to take advantage of this fast track for lifting the stay is for the debtor to be deemed a SARE debtor pursuant to section 101(51B). Under section 101(51B), to constitute a SARE, the following must be shown: (1) the debtor must have real property constituting a single property or project, other than residential real property with fewer than four residential units, (2) which generates substantially all of the gross income of the debtor, and (3) on which no substantial business is conducted other than the business of operating the real property and activities incidental thereto.[118]

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[114] "[S]ingle asset real estate" means real property constituting a single property or project, other than residential real property with fewer than 4 residential units, which generates substantially all of the gross income of a debtor who is not a family farmer and on which no substantial business is being conducted by a debtor other than the business of operating the real property and the activities incidental. 11 U.S.C. § 101(51B).

[115] 11 U.S.C. § 362(d)(3).

[116] In re Scotia Pacific Co., LLC, 508 F.3d 214, 220 (5th Cir. 2007).

[117] Id. at 225; see, e.g., In re Prairie Hills Golf & Ski Club, Inc., 255 B.R. 228 (Bankr. D. Neb. 2000) (holding that the debtor, an operator of a golf and ski club, was not a SARE debtor because it operated substantial business on the property); In re CBJ Development, Inc., 202 B.R. 467 (9th Cir. BAP 1996) (holding that hotel not a SARE because it conducted substantial business other than operation of real estate).

[118] Id. (holding that Chapter 11 debtor whose income was derived from harvesting of timber on 200,000 acres of land that it owned and on other property that it had contractual right to harvest conducted "substantial business" other than operation of the real estate and thus was not a SARE debtor).

### *E. Relief Due to Abusive Filings*

Under section 362(d)(4), the court may grant relief from the automatic stay as to a creditor whose claim is secured by an interest in real property, if the court finds that the filing of the bankruptcy case was part of a scheme to delay, hinder, and defraud creditors that involved either (1) a transfer of all or part of an ownership interest in real property without the creditor's consent or without court approval, or (2) multiple bankruptcy filings affecting the real property.[119] The purpose of this provision is to curb abusive filings.[120]

Because of the serious nature of this remedy, the creditor is required to demonstrate the existence of a scheme that hinders, delays, *and* defrauds the creditor through multiple bankruptcy filings. Unlike other references contained in the Bankruptcy Code, the "delay, hinder and defraud" language in section 362(d)(4) is couched in the conjunctive, requiring a creditor to demonstrate all three elements of a debtor's intent.[121]

If recorded in compliance with state law governing notice of a lien on real property, an order entered pursuant to section 362(d)(4) is binding in any other bankruptcy case for two years from the date of entry of the order.[122] A debtor in a subsequent case, however, may move for relief from the order based upon changed circumstances, or for good cause shown, after notice and a hearing.[123]

### *F. Ex Parte Relief*

The bankruptcy court may grant ex parte relief from the automatic stay in situations where irreparable damage might occur to the stayed party before there is an opportunity for notice and a hearing.[124] An ex parte order for relief will be granted only upon a verified statement that immediate and irreparable injury, loss, or damage will result if the stay is not lifted without notice, and if the movant's attorney certifies in writing the efforts, if any, made to

[119] 11 U.S.C. § 362(d)(4).
[120] H.R. Rep. No. 31, 109th Cong., 1st Sess., at 444 (2005).
[121] Id.; In re Smith, 395 B.R. 711 (Bankr. D. Kan. 2008).
[122] Id.
[123] Id.
[124] 11 U.S.C. § 362(f).

provide notice and the reasons why notice should not be required.[125] A hearing on relief from the stay must be held soon after the issuance of an ex parte order for relief.[126]

### *G. Burden of Proof*

When relief from automatic stay is sought, party seeking relief has initial burden to demonstrate cause for relief.[127] In a hearing on a relief stay motion brought under section 362(d) or (e), the burden of proof on the issue of the debtor's equity in the collateral is on the party requesting such relief.[128] The burden of proof on all other issues is on the debtor or the party opposing the motion.[129]

### *H. Ten-Day Stay of Order Granting Relief from Stay*

Pursuant to Bankruptcy Rule 4001, an order granting a motion for relief from the automatic stay is stayed for 10 days after entry of the order, unless the court orders otherwise.[130] So it is advisable to include a provision that nullifies the 10-day stay in any order granting relief from the automatic stay.

### *I. Liens Ordinarily Ride Through Bankruptcy*

If a secured creditor does not seek relief from the automatic stay before the conclusion of the case and the secured creditor's lien is not avoided under section 522(c)(2), its lien attaches to the real estate.[131] That is, a secured creditor's lien "rides (or passes) through" bankruptcy.[132] Liens that rides through bankruptcy may be enforced against the property but not against the

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[125] Id.
[126] Fed. R. Bankr. P. 4001(a)(2) ("On two days notice to the party who obtained relief from the stay without notice or on shorter notice to that party as the court may prescribe, the adverse party may appear and move for reinstatement of the stay . . . .").
[127] Pursue Energy Corp. v. Mississippi State Tax Com'n., 338 B.R. 283, 291 (S.D. Miss. 2005).
[128] 11 U.S.C. § 362(g).
[129] Id.; see In re Canal Place Ltd. P'ship, 921 F.2d 569 (5th Cir. 1991) (where creditor seeks relief from stay under section 362(d)(2) to foreclose on property, creditor has burden of establishing lack of equity in property and debtor has burden of establishing that property is effective for reorganization).
[130] Fed. R. Bankr. P. 4001(a)(3).
[131] See In re Orr, 180 F.3d 656 (5th Cir. 1999); In re Kinion, 207 F.3d 751, 757 n.12 (5th Cir. 2000) ("A creditor's lien rides through bankruptcy unaffected unless the Bankruptcy Code clearly permits there modification . . . ."); Long v. Bullard, 117 U.S. 617 (1886) (holding that a discharge in bankruptcy does not release real estate of the debtor from lien of a mortgage created by debtor before bankruptcy).
[132] See id.

debtor.[133] In other words, while the secured creditor may proceed in foreclosure following the close of the bankruptcy case, he may not seek a deficiency judgment, provided that the debtor did receive a discharge in bankruptcy and his case was not dismissed.

## VII. Abandonment of Property of the Estate

In addition to seeking relief from the automatic stay, a creditor with a lien against or security interest in real property of the debtor should seek abandonment of the property pursuant to section 554(b).[134] Section 554(b) permits a secured creditor or other party in interest to request the court to order the trustee or debtor in possession to abandon property of the estate that is burdensome or of inconsequential value and benefit to the estate.[135] For example, if there is no equity in the subject property, the property will be of "inconsequential value and benefit to the estate."[136]

A secured creditor or party in interest must file and serve a motion seeking to compel the trustee or debtor in possession to abandon property of the estate pursuant to Bankruptcy Rules 6007(b) and 9014.[137]

Obtaining an order for abandonment alone does not terminate the automatic stay. Rather, the stay continues, "until the earliest of (A) the time the case is closed; (B) the time the case is dismissed; or (C) . . . the time discharge is granted or denied."[138] Until such time, the property remains property of the debtor. Thus, a secured creditor should seek relief from the automatic stay and an order compelling the trustee or debtor in possession to abandon the property.

An interesting issue that has arisen with regard to abandonment is whether the

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[133] See In re Lindsey, 823 F.2d 189, 190 (7th Cir. 1987) ("A lienor need not, in order to enforce his lien, file a claim in his debtor's bankruptcy proceeding, though if he does not he loses the chance of enforcing any deficiency judgment against the assets of the bankrupt estate."); 11 U.S.C. § 506(a), (d).

[134] See Miss. Bankr. L.R. S7-1; Proposed Miss. Bankr. L.R. 6007-1(b). If the trustee wants to abandon the property, no court order is required so long as the trustee gives appropriate notice and no interested party objects within 15 days of the mailing of notice. 11 U.S.C. § 554(a); In re Kilbrew, 888 F.2d 1516 (5th Cir. 1989) (holding that trustee cannot abandon property of estate without affording creditors notice of intention to abandon such property). On the other hand, if a party in interests requests that the trustee abandons the property, a court order is required. 11 U.S.C. § 554(b).

[135] 11 U.S.C. § 554(b); H.R. Rep. No. 595, 95th Cong., 1st Sess., at 377 (1977).

[136] See 11 U.S.C. § 554(b); see also Fed. R. Bankr. P. 6007(b).

[137] Fed. R. Bankr. P. 6007(b).

[138] 11 U.S.C. § 362(c)(2)(A)-(C).

Bankruptcy Code permits the abandonment of property and related liabilities in order to avoid federal and state environmental obligations. In *Midlantic Nat'l Bank v. New Jersey Dept. of Envtl. Protection*,[139] the Supreme Court held that "a bankruptcy trustee could not abandon property in contravention of state statutes or regulations that are reasonably designed to protect the public health or safety from identified hazards."[140] Before authorizing abandonment, "the court must formulate conditions that will adequately protect the public's health and safety."[141] The "trustee's right to abandon environmentally impacted estate property is limited only by the precondition that the trustee remediate any imminent and identifiable danger present on the abandoned property."[142] Therefore, whether a court will allow a trustee or debtor in possession to abandon hazardous waste sites will turn on the facts of the particular case.

## VIII. Procedure

As discussed above, the initiation of a bankruptcy case vests the debtor with many rights and protections. But secured creditors are not left without opportunities to assert their claims and interests within the context of the bankruptcy case. As previously mentioned, one of the more commonly used remedies of the secured creditor is a motion for relief from the automatic stay coupled with a request to compel the trustee or debtor in possession to abandon property of the estate. Upon notice of the filing of a bankruptcy petition, a secured creditor seeking foreclosure of property of the debtor should generally move the court for relief from the automatic stay and for abandonment of the property, or alternatively, for the establishment of adequate protection. If the court determines that the creditors' interest in the debtor's property is adequately protected by, say, an equity cushion, the creditor should continue to monitor the case and the debtor's payments. If the debtor misses a payment, the secured creditor should immediately seek relief from the automatic stay and the abandonment of the property.

On the other hand, if it is apparent to the creditor that there is substantial equity in the

[139] 474 U.S. 494 (1986).
[140] Id.
[141] Id.
[142] In re Shore., Inc., 134 B.R. 572 (Bankr. E.D. Tex. 1991).

property and adequate protection could be established by the debtor, it may be appropriate for the creditor to negotiate with the debtor's counsel for a stipulation and agreed order requiring specific payments to the creditor and containing a "doomsday" or "drop dead" or "strict compliance" clause providing that the stay terminates and the creditor's collateral is abandonded if any periodic payments are missed and not timely cured.[143]

An alternative remedy for secured creditors is to file a motion to dismiss the debtor's bankruptcy case. In a Chapter 7 or Chapter 11 case, a party in interest may move for dismissal of the case "for cause."[144] "Cause" includes "unreasonable delay by the debtor that is prejudicial to creditors [or] . . . nonpayment of any fees or charges . . . ."[145] Dismissal of the bankruptcy case under section 707 or 1112 is without prejudice, unless otherwise ordered by the court.[146] The debtor is not barred from receiving a discharge of debts in a later case if the dismissal was before the discharge of the debts in the earlier case.[147] Furthermore, the dismissal reinstates any proceeding or custodianship; any transfer that was avoided under section 522, 544, 545, 547, 548, 549, or 724(a); and any lien voided under section 506(d).[148] More to the point, absent a court order to the contrary, the dismissal of a Chapter 7 or Chapter 11 case revests property of the estate in the prepetition owner and allows a foreclosing party to proceed with appropriate action.[149]

## IX. The Proof of Claim

In a Chapter 7 or Chapter 13 case, all unsecured creditors must file a proof of claim within the time limits prescribed by the Bankruptcy Code.[150] A secured creditor is not required to

[143] A "doomsday" (or "drop dead") clause is a provision for automatic relief from the stay upon the debtor's failure to comply with the terms required for adequate protection. Failure to reorganize or failure to comply with the terms and conditions of the stipulation will result in immediate relief from the automatic stay, abandonment of the property, and the right to proceed with foreclosure proceedings.
[144] 11 U.S.C. §§ 707(a), 1112(b)(1).
[145] 11 U.S.C. § 707(a)(1).
[146] 11 U.S.C. § 349(a).
[147] Id.
[148] 11 U.S.C. § 349(b)(1)(A)-(C).
[149] 11 U.S.C. § 349(3).
[150] Fed. R. Bankr. P. 3002(a). But see In re Eagle Bus Mfg., Inc., 62 F.3d 730 (5th Cir. 1995) (holding that where a creditor is not given adequate notice of claims bar date, due process requires that creditor be allowed to file a late claim; due process is satisfied if notice is given by mail in accordance with Bankruptcy Rules whether or not

file a proof of claim.[151] In a Chapter 9 or Chapter 11 case, only a creditor whose claim or interest is not scheduled, or is scheduled as disputed, contingent, or unliquidated, must file a proof of claim within the time set by the court.[152] It is the continuous responsibility of the creditor to determine whether its claim is accurately listed, especially when the debtor amends his or her schedules. Notably, however, in *In re Woodward*,[153] the bankruptcy court in Nebraska held that, while a creditor in a Chapter 11 case was not required to file a proof of claim in order to participate in plan distribution, a creditor was required to file a proof of claim in order to vote on the plan. So, while there are instances where creditors are not required to file a proof of claim, it is generally recommended that all creditors file proofs of claim in all cases, except in a no-asset Chapter 7 case in which creditors have been instructed not to file claims. Reasons for not filing a proof of claim include wanting to ensure a jury trial can be held or not wanting to submit to the jurisdiction of the bankruptcy court.

The filing of a proof of claim "constitute[s] prima facie evidence of the validity and amount of the claim."[154] Any party objecting to the proof of claim has the initial burden of going forward with evidence sufficient to rebut the prima facie validity of the claim.[155] Only after the objecting party has met this burden, does the burden of proof shift to the claimant.[156]

In a Chapter 7, 12, or 13 case, a proof of claim must be filed within 90 days after the first date set for the meeting of creditors under section 341(a).[157]

In a Chapter 7 case, the notice of bankruptcy, which follows the notice scheduling the section 341 creditors' meeting, will contain a statement as to whether proofs of claims must be filed. In the vast majority of Chapter 7 cases, filing a proof of claim is fruitless because the debtor has no unencumbered assets. If unencumbered assets are subsequently discovered, a

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creditor actually received it).

[151] Id.

[152] Fed. R. Bankr. P. 3003(c)(2)-(3); 11 U.S.C. § 502(a) (claim is deemed allowed when a proof of claim is filed, if no party in interest objects).

[153] 2013 WL 5888459 (Bankr. D. Neb. Oct. 31, 2013).

[154] Fed. R. Bankr. P. 3001(f).

[155] In re Century Inns, 59 B.R. 507 (Bankr. S.D. Miss. 1986).

[156] Id.

[157] Fed. R. Bankr. P. 3002(c).

special notice will be sent out to all creditors by the clerk of the court advising of the deadline for filing claims.

If a creditor fails to or does not timely file a proof of claim, a co-creditor, a trustee, or the debtor may file the claim on behalf of the creditor.[158]

When a claim is based on a writing, the original or duplicate must be filed with the proof of claim.[159] And if a security interest in property of the estate is claimed, evidence that the interest has been perfected must be filed with the proof of claim.[160] Once the proper form for a proof of claim is prepared, the proof of claim must be filed with the clerk of the court in the district where the case is pending.[161]

Despite the foregoing, a precautionary rule to follow when representing a secured creditor is to file a proof of claim in every case (except in no-asset Chapter 7 cases were creditors are instructed by the court clerk not to file proofs of claim). Pursuant to section 501, any creditor *may* file a proof of claim in any case. So, if in doubt, file a proof of claim.

## X. Section 1111(b)(2) Election

In a Chapter 11 case, a secured creditor may elect to be treated as a non-recourse lender in accordance with section 1111(b)(2). Generally, each secured creditor is placed into a class by itself, and the creditor's claim is secured only up to the value of the collateral and unsecured for the balance of the claim.[162] Section 1111(b)(2) provides that a class of claims may elect to have a secured claim to the full extent the claim is allowed rather than only to the extent of the collateral.[163] In other words, if a class of claims elects application of section 1111(b)(2), the claims become fully secured and the value is not limited to the interest in the collateral.[164]

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[158] 11 U.S.C. § 501(b)-(d).
[159] Fed. R. Bankr. P. 3001(c).
[160] Fed. R. Bankr. P. 3001(d).
[161] Fed. R. Bankr. P. 5005(a).
[162] 11 U.S.C. § 506(a).
[163] 11 U.S.C. § 1111(b)(2).
[164] 1 THOMAS J. SALERNO, ET AL. BANKRUPTCY LITIGATION AND PRACTICE § 7.81 (1995); In re Swiftco, Inc., 1988 WL 143714, at *17 (Bankr. S.D. Tex. Oct. 5, 1988) (finding that if class does not elect application of section 1111(b)(2), then allowed about is value of collateral; if election is made, allowed amount is amount of debt).

The section 1111(b)(2) election may be attractive where a creditor is undersecured,[165] the property is appreciating in value, or the collateral will be sold soon after plan confirmation.

The primary purpose of the section 1111(b)(2) election is to give the holder of an undersecured claim the benefit of any post-confirmation appreciation in the collateral. The tradeoff is that the holder of the claim loses the right to assert any deficiency claim and the possibility of influencing the vote during confirmation of the plan.

A section 1111(b)(2) election may be made at any time before the conclusion of the hearing on the disclosure statement or within the time set by the court.[166]

A class may elect application of section 1111(b)(2) only if the security interest is not of inconsequential value, or if the creditor is a recourse creditor and the property is sold under section 363 or is to be sold under the Chapter 11 plan.[167] The valuation battle is left to the litigants with the same pitfalls and uncertainties that are present in the stay relief valuation battle.

Should a secured creditor elect application of section 1111(b)(2), he should consider giving notice of the election to any guarantors or codebtors to preserve any deficiency rights against them.

## XI. Fraudulent Conveyances

An issue in bankruptcy law that has generated significant discussion is whether the trustee may use section 548(a)(1)(B) to set aside a foreclosure sale as a fraudulent transfer if the sale provides less than a "reasonably equivalent value" in exchange for the property.[168] Section 548 sets forth the powers of the trustee or debtor in possession to set aside or avoid fraudulent transfers. It permits the trustee to avoid not only transfers involving actual fraud but also constructively fraudulent transfers, including those transfers made for less than "reasonably equivalent value." Specifically, section 548(a)(1)(B) provides in pertinent part:

> The trustee may avoid any transfer . . . incurred by the debtor, that

[165] A claim is undersecured when "[t]he claim is equal to the value of the collateral and the deficiency is treated as an unsecured claim." 1 THOMAS J. SALERNO, ET AL., BANKRUPTCY LITIGATION AND PRACTICE § 4.48 (1995).
[166] Fed. R. Bankr. P. 3014.
[167] 11 U.S.C. § 1111(b)(1)(B)(i)-(ii).
[168] 11 U.S.C. § 548(a)(1)(B).

> was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily . . . received less than a reasonably equivalent value in exchange for such transfer . . . and . . . was insolvent . . . or became insolvent as a result of such transfer . . . .[169]

Section 548 applies to "any" transfer, including "the foreclosure of the debtor's equity of redemption."[170] Thus the question arises whether the amount of debt satisfied at the foreclosure sale of the debtor's property is "reasonably equivalent" to the worth of the real estate conveyed.[171]

In *Durrett v. Washington National Insurance Company*[172], the U.S. Fifth Circuit Court of Appeals, interpreting a provision of the old Bankruptcy Act analogous to section 548(a)(1)(B), held that a foreclosure sale of a debtor's property that realized 57% of the property's fair market value could be avoided by the trustee.[173] Further, the court noted that any foreclosure sale that yielded less than 70% of the property's fair market value should be avoided.[174] This aside became known as the "*Durrett* rule."[175]

In *BFP v. Resolution Trust Corporation*, the U.S. Supreme Court rejected the *Durrett* rule holding that under section 548(a), "a fair and proper price, or a 'reasonably equivalent value,' for foreclosed property, is the price in fact received at the foreclosure sale, so long as all the requirements of the State's foreclosure law have been complied with" and the sale was noncollusive.[176] In other words, "reasonably equivalent value" is presumptively established as the price received at a noncollusive foreclosure sale, so long as the requirements of the State's foreclosure law are complied with.[177] According to Justice Scalia, market value "has no

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[169] Id.
[170] 11 U.S.C. § 101(54)(C); BFP v. Resolution Trust Corp., 511 U.S. 531, 535 (1994) (quoting 11 U.S.C. § 101(54) (1988 ed., Supp. IV)).
[171] BFP, 511 U.S. at 535.
[172] 621 F.2d 201 (5th Cir. 1980).
[173] Id. at 203.
[174] Id. at 204.
[175] BFP, 511 U.S. at 545.
[176] Id.
[177] In re Villarreal, 2008 WL 717551, at *1 (Bankr. S.D. Tex Mar. 14, 2008).

applicability in the forced sale context."[178]

While the holding in *BFP* was expressly limited to "mortgage foreclosures of real estate,"[179] the Fifth Circuit, in *T.F. Stone Company, Inc. v. Harper* (*In re T.F. Stone Company, Inc.*), extended the rule to tax foreclosure sales.[180] The court held that "a peppercorn price received in a noncollusive, lawfully conducted tax foreclosure sale of the real property of a Chapter 11 debtor" could not be avoided under section 549(c).[181] Accordingly, so long as a mortgage foreclosure of real property of the debtor is noncollusive and conducted in accordance with state law, it probably cannot be set aside by the trustee under section 548(a)(1)(B).[182]

Notably, while a properly conducted foreclosure for any price may not be deemed a fraudulent conveyance under the Bankruptcy Code, under Mississippi law, the winning bid must be at least 40% of the fair market value of the property or the sale is subject to being set aside for a grossly inadequate price.[183]

Please note that the foreclosing attorney should always advise the lienholder and the title insurance company that the trustee may avoid any transfer of interest of the debtor in property under section 548 after the earlier of two years after the entry of the order for relief, one year after the appointment or election of the first trustee, or the time the case is closed or dismissed.[184]

## XII. The Homestead Exemption

Pertinent to secured creditors is the debtor's right to claim his or her homestead as exempt property. Miss. Code Ann. § 85-3-21 sets forth the qualifications for claiming a homestead exemption, as well as the rights and immunities pertaining thereto. It states in relevant part:

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[178] BFP, 511 U.S. at 545.
[179] Id. at 537 n.3.
[180] 72 F.3d 466 (5th Cir. 1995).
[181] Id.
[182] See id.; Villarreal, 2008 WL 717551, at *1.
[183] Allied Steel Corp. v. Cooper, 607 So. 2d 113, 120 (Miss. 1992) ("This Court long followed the rule of thumb of "about forty percent" of fair market value first articulated in *Weyburn v. Watkins,* 90 Miss. 728, 733-36, 44 So. 145, 145-146 (1907)).
[184] 11 U.S.C. § 546(a). But see In re Texas General Petroleum Corp., 52 F.3d 1330 (5th Cir. 1995) (holding that section 546(a) limitation period was not a nonwaivable limit on the court's jurisdiction and thus defendant waived limitations defense by not raising it at postconfirmation fraudulent conveyance trial).

> Every citizen of this state, male or female, being a householder shall be entitled to hold exempt from seizure or sale, under execution or attachment, the land and building owned and occupied as a residence by him, or her, but the quality shall not exceed one hundred sixty (160) acres, nor the value thereof, inclusive of improvements, save as hereinafter provided, the sum of Seventy-Five Thousand Dollars ($75,000) . . . .

In construing this statute, the Mississippi Supreme Court has established a rule of construction that requires resolution of doubt or ambiguity in the debtor's favor.[185] The controlling factor in determining the homestead character of any parcel is "whether or not the property is devoted to homestead purposes . . . ."[186] The concern of the homestead exemption is to protect the entire family from misfortune or imprudence of its primary breadwinner.[187]

In *Campbell v. Adair*,[188] the Mississippi Supreme Court set forth the elements that must be met before one is entitled to the homestead exemption:

> As a general rule, to constitute a homestead there must be actual occupation and use of the premises as a home for the family. The premises must be appropriated, dedicated or used for the purpose designated by the law, to-wit: as a home, a place to abide and reside on, a "home for the family."[189]

Furthermore, "this use must be active and not constructive."[190]

Notably, since the focus of the Mississippi homestead exemption has historically been upon the ownership of land, a debtor may not claim a mobile home as exempt property where the debtor does not also own the land upon which the mobile home is situated.[191]

Consensual liens such as deeds of trust are not subject to the homestead exemption.[192] It only applies to nonconsensual liens such as judgment liens.

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[185] See Dogan v. Cooley, 185 So. 783, 790-91 (Miss. 1939); McMillan v. Aru, 773 So. 2d 355 (Miss. Ct. App. 2000).
[186] Shows v. Watkins, 485 So. 2d 288, 291 (Miss. 1986) (quoting Horton v. Horton, 48 So. 2d 850, 855 (Miss. 1950)).
[187] See Williamson v. Williamson, 844 F.2d 1166 (5th Cir. 1988).
[188] Campbell v. Adair, 45 Miss. 170 (1871).
[189] Id. at 177-78
[190] Id. at 178.
[191] In re Cobbins, 227 F.3d 302 (5th Cir. 2000). Furthermore, a debtor cannot claim an exemption of his or her mobile home as personal property under Miss. Code Ann. § 85-3-1. Id.
[192] Miss. Code Ann. § 85-3-21 ("existing encumbrances on such land and buildings, including taxes and other liens, shall first be deducted from the actual value of such land and buildings.")

## XIII. *Show Me State* Case Scenarios

In 1960, the United States Supreme Court held in *United States v. Bronsan*[193] that a junior federal lien on real property could be extinguished by a nonjudicial foreclosure conducted in accordance with state law, even if state law required no notice to the United States. In response, Congress amended 28 U.S.C. § 2410(c) to state that "an action to foreclose a mortgage or other lien, naming the United States as a party under this section must seek judicial sale." This language is buried in the middle of the statute, and when read in context, not abundantly clear. While John Underwood understood the import of the revised section 2410(c),[194] most practitioners and title companies did not. As First American Title said in NA-2024-003, "for many decades, most title companies, mortgage lenders, and real estate legal practitioners have assumed that state law governs the rights of the United States whenever there is a nonjudicial foreclosure of a senior lien that purports to extinguish a non-IRS junior federal lien on property."

Then, on July 20, 2023, the U.S. Court of Appeals for the Eighth Circuit handed down *Show Me State Premium Homes, LLC v. McDonnell*[195] in which it held that a nonjudicial tax sale did not extinguish two deeds of trust held by the U.S. Department of Housing and Urban Development (HUD) on a Missouri home, pursuant to 28 U.S.C. § 2410. The opinion detailed how section 2410(c) was amended after *Brosnan* to prohibit the extinguishment of junior federal liens by nonjudicial sales. The opinion sent shockwaves through the foreclosure industry. The U.S. Department of Justice began aggressively asserting that nonjudicial foreclosures had no effect on non-IRS junior federal liens held by the United States. Beginning in late 2023, many mortgage servicers had begun converting nonjudicial foreclosures to judicial foreclosures whenever a Show Me State scenario existed, i.e., whenever a subordinate federal lien appeared on the title search report. And by mid-2024, most title companies had issued bulletins advising that any unreleased non-IRS junior federal liens must be shown as an exception in the policy

[193] 363 U.S. 237.
[194] John C. Underwood, Jr. "Foreclosure Law and Procedure," § 2.39, Foreclosure Law in Mississippi Practice Handbook (2014). See also Guild Mortg. Co. v. Prestwick Court Trust, 207
[195] 74 F. 4th 911.

following a nonjudicial foreclosure of a prior senior lien.

The bottom line is that to extinguish a non-IRS junior federal lien on property, the senior lienholder should proceed judicially instead of nonjudicially, unless and until further guidance is provided by the United States. On August 20, 2024, HUD released Mortgagee Letter 2024-17 setting forth interim procedures to for lenders and servicers to clear subordinate HUD liens on properties that should have been foreclosed judicially but were not.

## XIII. Conclusion

The filing of a bankruptcy petition under any chapter of the Bankruptcy Code operates as an automatic stay of the commencement or continuation of virtually any act affecting the debtor or the debtor's property. The automatic stay prevents secured creditors from proceeding against property of the debtor, including the continuation or commencement of a foreclosure action. Failure to honor the automatic stay may result in compensatory damages, or even punitive damages, being levied against the violator.

Shortly after the bankruptcy petition is filed, a secured creditor must take affirmative action to file a proof of claim and a motion seeking abandonment of the collateral and lifting of the automatic stay, or in the alternative, seeking adequate protection. The Bankruptcy Code provides the court with four alternatives in fashioning stay relief – termination, annulment, modification, or conditions. Additionally, a motion to dismiss, if well founded, can be an effective creditor remedy. In either case, before any action is taken, the foreclosing creditor should weigh the benefits to be gained against the liabilities that may be incurred from filing the claim or motion.