

AMERICAN BANKRUPTCY INSTITUTE JOURNAL

The Essential Resource for Today's Busy Insolvency Professional

Feature

BY KAYLA D. BRITTON¹

Are We Protecting Too Much? The Intersection of §§ 362(a)(5) and 554

The Bankruptcy Code provides important protections to debtors and their creditors by promoting equitable distribution, granting the corporate debtor the necessary “breathing spell”² to effect a successful reorganization or orderly liquidation, and providing the individual debtor with a fresh start. However, when the Code’s provisions no longer promote those goals and serve only to waste the resources of the parties involved and the courts, its provisions should be reconsidered. As demonstrated by *Gasprom Inc. v. Fateh (In re Gasprom Inc.)*,³ such is the case when § 362(a)(5) of the Bankruptcy Code is applied to corporate debtors or to property of the estate that was abandoned by the trustee.



Kayla D. Britton
Faegre Baker Daniels
Indianapolis

Kayla Britton
is an associate
with Faegre
Baker Daniels in
Indianapolis.

Failure to Seek Stay Relief Results in Protracted Litigation

Gasprom was commenced as a chapter 11 case, but quickly converted to chapter 7.⁴ The chapter 7 trustee filed a notice of intent to abandon the debtor’s primary asset, a nonoperational gas station, to which the debtor objected. The chapter 7 trustee submitted evidence in support of abandonment, including evidence that the gas station was fully encumbered and that “she did not have any funds available to render the Gas Station operational ... [or] to address a number of troublesome issues concerning permitting, hazardous waste contamination and underground storage tank compliance.”⁵ The bankruptcy court authorized abandonment and noted at the hearing that, upon abandonment, the gas station would no longer constitute property of

the estate or be protected by the automatic stay.⁶ The bankruptcy court’s order authorized the abandonment of the gas station but did not address the automatic stay.⁷ The lender proceeded with the foreclosure sale, and the debtor’s bankruptcy case was closed 15 days later.

The debtor moved to reopen the case in order to have the foreclosure sale set aside and to commence contempt proceedings against the lender for violation of the automatic stay. The bankruptcy court upheld the foreclosure sale and determined that no stay applied to the gas station after entry of the abandonment order.⁸ Alternatively, the bankruptcy court ruled that it would annul the automatic stay retroactively to validate the foreclosure sale.

On appeal, the Ninth Circuit Bankruptcy Appellate Panel (BAP) ruled that the foreclosure sale violated the automatic stay because the lender had not received stay relief.⁹ Upon abandonment, the gas station title reverted to the debtor and, pursuant to § 362(a)(5), the automatic stay extended to “property of the debtor,” including the abandoned gas station. On remand, the debtor filed a renewed motion to set aside the foreclosure sale,¹⁰ and the lender filed a motion to annul the stay retroactively to validate the foreclosure sale.¹¹ After nearly two years of litigation, the bankruptcy court denied the debtor’s motion to set aside the sale and entered an order annulling the stay retroactively to the date and time immediately prior to the foreclosure sale.¹²

6 *Id.* at 602, n.5.

7 *Id.* at 602.

8 *Id.* at 603; see also Order on Gasprom Inc.’s Motion to Set Aside Foreclosure for an Order to Show Cause Re: Contempt for Violation of Automatic Stay, No. 12-10772 (Bankr. C.D. Cal. Dec. 4, 2012), ECF No. 64.

9 *Gasprom*, 500 B.R. at 604.

10 Motion for Order Setting Aside Foreclosure and for Order to Show Cause Re: Contempt, No. 12-10772 (Bankr. C.D. Cal. Nov. 20, 2013), ECF No. 80.

11 Motion to Annul Bankruptcy Stay, No. 12-10772 (Bankr. C.D. Cal. Dec. 4, 2013), ECF No. 87.

12 Order Granting Motion to Annul Bankruptcy Stay and Denying Motion to Set Aside Foreclosure and for OSC Re: Contempt, No. 12-10772 (Bankr. C.D. Cal. Jan. 7, 2014), ECF No. 102.

1 A special thanks to **Jay Jaffe** for his support and assistance in writing this article.

2 *Teachers Ins. and Annuity Assoc. of Am. v. Butler*, 803 F.2d 61, 64 (2d Cir. 1986) (quoting S. Rep. No. 989, 95th Congress, 2d Sess. 54-55 (1978)).

3 500 B.R. 598 (B.A.P. 9th Cir. 2013).

4 *Gasprom*, 500 B.R. 598 (providing that case was converted within one month of filing).

5 *Id.* at 601.

Implications of *Gasprom*

Gasprom demonstrates the inherent flexibility of § 362(a)(5). The bankruptcy court intended for the foreclosure sale to proceed as scheduled, but the lender failed to file a motion for relief from stay — likely due to its understanding that the bankruptcy court authorized the sale to proceed. Because the BAP concluded that the gas station reverted back to the debtor upon abandonment, the BAP held that the gas station constituted property of the debtor and was protected under § 362(a)(5). After two years of litigation, the foreclosure sale was upheld by the bankruptcy court on remand. The debtor gained nothing by the litigation, yet the lender and the courts were required to expend significant resources in adjudicating the dispute.

The impractical — and often unnecessary — results compelled by a plain-language interpretation of § 362(a)(5) are further underscored by the intersection of §§ 362(a)(5) and 554. Section 554 provides that property may be abandoned, after notice and a hearing, if the property “is burdensome to the estate or ... is of inconsequential value and benefit to the estate.”¹³ While § 554 is silent on the issue, abandoned property is typically found to revert to the debtor, as in *Gasprom*, thereby purportedly becoming property of the debtor.¹⁴ As noted by the *Gasprom* court, abandoned property ceases to be property of the estate, yet it is still protected by the automatic stay as “property of the debtor.”¹⁵ In other words, a plain-language interpretation of § 362(a)(5) suggests that property that has been determined to be of inconsequential value or benefit to the estate continues to merit protection by the Bankruptcy Code.

The confounding interplay between §§ 362(a)(5) and 554 is further complicated by § 362(c)(1), which provides that “the stay of an act against property of the estate under subsection (a) of this section continues until such property is no longer property of the estate.” Pursuant to the plain language of § 362(c)(1), the automatic stay terminates as to abandoned property.¹⁶ However, upon abandonment, the property reverts to the debtor, becoming property of the debtor and thereby receiving the protections of § 362(a)(5). Was § 362(a)(5) intended to resurrect the stay on abandoned property that was expressly terminated by § 362(c)(1)?

The Scope of § 362(a)(5) Should Be Reconsidered

The protections afforded by § 362(a) are intended to safeguard the rights that are afforded by the rest of the Bankruptcy Code.¹⁷ Accordingly, when the terms of § 362 do not provide any benefit to the debtor or its estate, they should be reconsidered. While § 362(a)(5) may serve a legitimate purpose in individual debtor cases with respect to property that was acquired after the filing of a case, it provides no benefit in corporate debtor cases or with respect to abandoned property

of the estate. Rather, it seems only to cause additional, undue expense and delay for secured creditors who are required to seek relief from stay before enforcing their liens when the debtor can have no legitimate defense to such a motion and to waste judicial resources by requiring bankruptcy courts to consider motions for relief from stay that will routinely be granted as a matter of course. As such, § 362(a)(5) should be amended to apply only to property of the debtor *who is an individual* and to carve out abandoned property of the estate.

Where a bankruptcy court has determined that property is burdensome to the estate or is of inconsequential value or benefit to the estate under § 554, grounds for relief from the stay under § 362(d) will be easy to prove. Pursuant to § 362(d), a court may grant relief from the automatic stay “for cause” or “if (A) the debtor does not have an equity in such property; and (B) such property is not necessary to an effective reorganization.”¹⁸ In *Gasprom*, the trustee’s proffered evidence in support of abandonment was that (1) there was environmental contamination on the property and (2) there was no equity in the property. The same evidence would have supported relief from stay under § 362(d).

While the requirement of filing a motion for relief from the stay and paying the requisite filing fee might be merely an inconvenience to certain secured creditors, it eliminates the ability of secured creditors with small claims to enforce their rights in a timely manner. Legal costs and filing fees associated with a motion for stay relief can easily outweigh the value of the claim. In such a circumstance, the secured creditor must wait for the case to be closed or dismissed or for the debtor to be discharged.¹⁹ Section 362(e) demonstrates congressional concern for protecting secured creditors’ rights by setting forth a detailed statutory time frame for judicial consideration of motions for stay relief.²⁰ This concern should receive renewed attention when secured creditors are compelled to suffer further expense and delay without any countervailing benefit to the debtor or its estate. A debtor is not harmed when a secured creditor enforces its lien, *in rem*, on abandoned property that has been held to be unnecessary to an effective reorganization and to be of no consequential value or benefit to the estate. Likewise, other parties with interests in the abandoned property are not harmed when they are required to appear in state court to assert their interests in the property, as they would have been required to do had there been no bankruptcy filing.

Congress included § 362(a)(5) in order to extend the protection of the automatic stay to property of the debtor “where necessary to protect a significant right of the debtor under the Bankruptcy Code.”²¹ Such “significant rights” include the debtor’s discharge, exemptions, lien-avoidance rights, rights of redemption and reaffirmation rights.²² As argued in *Gasprom*, these rights are only potentially meaningful when the debtor is an individual. There are no analogous policy reasons supporting application of the automatic stay to any property of a corporate debtor, let alone abandoned property.

The continued degree of utility of § 362(a)(5) even as to individual debtors is questionable, particularly in the context of

13 11 U.S.C. § 554(a) and (b).

14 Section 362(a)(5) extends the protection of the automatic stay to “property of the debtor,” which, as noted by the legislative history, includes “most property that is acquired after the date of the filing of the petition, property that is exempted, or property that does not pass to the estate.” H.R. Rep. No. 95-595 (1977) (Conf. Rep.).

15 *Gasprom*, 500 B.R. at 604.

16 See H.R. Rep. No. 95-595 (1977) (Conf. Rep.) (“Paragraph (1) [of § 362(c)] terminates a stay of an act against property of the estate when the property ceases to be property of the estate, such as by sale, abandonment, or exemption.”).

17 See *id.* (“[The automatic stay] permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy.”).

18 11 U.S.C. § 362(d)(1) and (2).

19 11 U.S.C. § 362(c)(2).

20 See H.R. Rep. No. 95-595 (1977) (Conf. Rep.).

21 *D’Annie’s Restaurant Inc. v. Northwestern Nat’l Bank of Mankato (In re D’Annie’s Restaurant Inc.)*, 15 B.R. 828, 831 (Bankr. D. Minn. 1981).

22 *Id.* at 831.

abandoned property (where the lien had attached pre-petition) as opposed to after-acquired property (where the automatic stay and the debtor's discharge would prevent the secured party's lien from attaching). Rights that are purportedly protected by § 362(a)(5) are not impacted by a creditor's enforcement of its pre-petition lien as to abandoned property. A debtor's right to redeem personal property continues under state law, and the stay does not provide any meaningful additional protection. Reaffirmation rights pursuant to § 524(c) are already contingent on the debtor's ability to reach an agreement with the creditor. A creditor cannot be compelled to accept a reaffirmation agreement, and one who is willing to do so would be unlikely to waste time and resources on an enforcement action.

Further, the compressed timeline for individual debtors to reaffirm debt mitigates the potential argument that removing the protections of the automatic stay as to abandoned property provides leverage to secured creditors and encourages the strong-arming of debtors into reaffirming secured debt. Debtors are required to file a statement of intention with regard to secured debt pursuant to § 521 on the earlier of (1) 30 days of the petition date and (2) the date of the § 341 meeting of creditors. Section 521(a)(2)(B) also requires that debtors perform such intention within 30 days of the first date set for the § 341 meeting of creditors.²³ A debtor, therefore, has only a few months to reaffirm debt, and decisions regarding abandonment are unlikely to occur during that time.

Likewise, a debtor's lien-avoidance rights under § 522 are not impaired. Debtors are free to move to avoid liens at any time during the bankruptcy case. As set forth above, debtors are required at the outset of the case to analyze their secured debts and determine the desired course of action. Debtors receive no justifiable benefit in ambushing the creditor with a delayed lien-avoidance motion. The ultimate abandonment of certain property does not prevent a debtor from seeking a delayed filing of the abandonment notice or from immediately moving to avoid the lien upon receipt of such notice.

Conclusion

Amending § 362(a)(5) to apply only to property of individual debtors, and to carve out abandoned property of the estate, appropriately and equitably balances the interests of all the bankruptcy players — the debtor, its estate and creditors, and the court — and avoids the impractical results of cases like *Gasprom*. *Gasprom* might be an example of bad facts making bad law, but it certainly demonstrates the problems that are inherent in the current reading of § 362(a)(5), especially in the context of corporate debtors and with respect to abandoned property. Of course, *Gasprom* also serves as a warning to creditors to not rely on abandonment alone before enforcing *in rem* remedies. **abi**

Reprinted with permission from the ABI Journal, Vol. XXXIII, No. 4, April 2014.

The American Bankruptcy Institute is a multi-disciplinary, non-partisan organization devoted to bankruptcy issues. ABI has more than 13,000 members, representing all facets of the insolvency field. For more information, visit ABI World at www.abiworld.org.

²³ Rule 4008 of the Federal Rules of Bankruptcy Procedure specifically requires that a reaffirmation agreement be filed within 60 days after the first date set for the § 341 meeting of creditors.