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Giving Teeth To A Repeat-Filing Statute

Law360, New York (April 7, 2011, 1:21 PM ET) -- Congress enacted Section 362(c)(3)(A) of the Bankruptcy Code as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) to deter debtors from filing multiple bankruptcy cases for the sole purpose of frustrating a creditor's legitimate rights as a creditor.

Section 362(c)(3)(A) provides that the automatic stay expires 30 days after the commencement of an individual debtor's bankruptcy case if such debtor previously filed a bankruptcy case within one year that was subsequently dismissed.

Since its enactment, Section 362(c)(3)(A) has caused significant confusion among bankruptcy courts across the country. In fact, two separate and opposite interpretations have emerged. The majority of courts have interpreted Section 362(c)(3)(A) as terminating the automatic stay only as to the debtor but not as to property of the debtor's bankruptcy estate.

Under this construction, a secured creditor could seek to enforce its rights against the debtor personally, but could not commence an action to, for example, foreclose on its collateral without first moving for relief from the automatic stay. A minority of courts have held that Section 362(c)(3)(A) terminates the automatic stay as to both the debtor and property of the debtor's bankruptcy estate.

Given the increase in bad-faith repeat filings by creditors primarily seeking to prevent foreclosure, Section 362(c)(3)(A) is quickly becoming an important statutory remedy for secured creditors in their fight against borrowers who abuse the bankruptcy system.

On Feb. 4, the Ninth Circuit Bankruptcy Appellate Panel (the BAP), following the minority interpretation of Section 362(c)(3)(A), held that the automatic stay terminated as to the debtor and property of the debtor's bankruptcy estate 30 days after the debtor's second bankruptcy filing.[1] By doing so, the BAP added much-needed teeth to a statute designed to discourage multiple filings and to protect creditors from abusive debtors.

In order to understand congressional intent in enacting Section 362(c)(3)(A) as part of the BAPCPA, it is important to understand the prevalence of abusive behavior common among multiple bankruptcy filers.[2] This problem has only been exacerbated by the most recent economic meltdown, coined the "Great Recession," that commenced in 2007. Between 2006 and 2010, the number of bankruptcy filings in the U.S. nearly tripled.[3]

At least 28 percent of Chapter 13 cases in 2009 were filed by debtors who had filed a bankruptcy petition within the previous eight years.[4] The BAPCPA added Section 362(c)(3)(A) to the Bankruptcy Code in an effort to discourage bad-faith filings.

However, as explained below, the majority of courts interpreting Section 362(c)(3)(A) have stripped the section of any meaningful implications for those debtors seeking to file repeat cases in an effort to avoid their obligations to creditors.

Section 362(c)(3)(A) of the Bankruptcy Code provides in pertinent part:

"(c) Except as provided in subsections (d), (e), (f) and (h) of this section ...

"(3) If a single or joint case is filed by or against debtor who is an individual in a case under Chapter 7, 11 or 13 and if a single or joint case of the debtor was pending within the preceding one-year period but was dismissed, other than a case refiled under a chapter other than Chapter 7 after dismissal under Section 707(b) ... (A) the stay under subsection (a) with respect to any action taken with respect to a debt or property securing such debt or with respect to any lease shall terminate with respect to the debtor on the 30th day after the filing of the later case."

The section of the BAPCPA that added Section 362(c)(3)(A) was titled "Discouraging Bad Faith Repeat Filings." [5]

Specifically, the BAPCPA states that "Section 302 of the [BAPCPA] amends Section 362(c) of the Bankruptcy Code to terminate the automatic stay within 30 days in a Chapter 7, 11 or 13 case filed by or against an individual if such individual was a debtor in a previously dismissed case pending within the preceding one-year period." [6]

As noted in Reswick, "successive bankruptcy filings have caused significant problems within the bankruptcy system and for creditors seeking to pursue state law remedies." [7] These filings are increasingly prevalent for underwater borrowers who attempt to avoid foreclosure of their properties.

Despite the clear language in the BAPCPA that the automatic stay terminates within 30 days of an individual's second filing, the language of Section 362(c)(3)(A) is far less clear. In fact, the Bankruptcy Court for the Northern District of Illinois noted that Section 362(c)(3)(A) is subject to four different interpretations. [8]

The majority of courts have interpreted the statute to provide that the automatic stay only terminates as to the debtor and the debtor's property, but not as to property of the debtor's bankruptcy estate, 30 days after the second bankruptcy case is filed. [9] The Tenth Circuit BAP, adopting the majority interpretation, found that the majority position was "more faithful to the language of the statute." [10]

However, the majority interpretation of Section 362(c)(3)(A) effectively renders the section meaningless. Absent termination of the automatic stay as to both the debtor AND property of the bankruptcy estate, creditors are simply unable to meaningfully enforce their state law remedies against repeat filers. This result is at odds with the intent of Congress.

Not only was Section 362(c)(3)(A) added as part of the BAPCPA, but the section of the act adding Section 362(c)(3)(A) was titled: "Discouraging Bad Faith Repeat Filings." Thus, the majority interpretation, by limiting the termination of the stay as to the debtor and the debtor's property, fails to prevent bankruptcy abuse or discourage bad faith repeat filings.

Take for example the following factual circumstances. A debtor stops making payments to secured creditor on rental property owned by the debtor. The debtor continues to collect rent from tenants without paying his secured creditor. On the eve of the foreclosure sale, the debtor files a bankruptcy petition. The secured creditor files a motion for relief from stay in the debtor's case.

Prior to entry of an order granting relief from stay, the debtor voluntarily dismisses the bankruptcy case and subsequently files another bankruptcy case. And this game can go on and on for many months. Under the majority interpretation, the secured creditor would be forced to file another motion for relief from stay and incur additional costs to pursue its

state law remedies against property of the estate. This cannot be what Congress intended when it enacted Section 362(c)(3)(A).

Recognizing these deficiencies in the majority rule, the BAP in Reswick, interpreted Section 362(c)(3)(A) of the Bankruptcy Code as terminating the automatic stay as to both the debtor and property of the debtor's bankruptcy estate.[11] The BAP's opinion correctly noted that the majority interpretation renders Section 362(c)(3)(A) with little meaning and even less teeth.

"Indeed, this interpretation would provide no meaningful relief to creditors in Chapter 13 cases, where repeat filings are most prevalent. Creditors in a Chapter 13 case could take no action against property that the debtor owned at the time the case was commenced, because it is property of the estate under Section 541(a)(1), and they could take no action against property that the debtor acquired postpetition because it would also constitute property of the estate under Section 1306(a)."[12]

The foregoing example illustrates how the majority view has essentially stripped Section 362(c)(3)(A) of any meaning which would deter subsequent filings, thereby forcing legitimate secured creditors to endure multiple filings by bad faith debtors.[13]

The legislative history clearly articulates that "Congress intended to deter successive bankruptcy filings by imposing stricter limitations on the power of the automatic stay as subsequent bankruptcy cases are filed." [14] Thus, it is inconceivable that Congress would adopt a provision intended to defer repeat filers which would be meaningless as to the majority of repeat filers.

Additionally, the Reswick opinion does not prevent legitimate creditors, the debtor or a trustee from protecting property of the estate which may be of value for the estate. Section 362(c)(3)(B) permits a "party in interest" to seek an extension of the 30-day stay provided in Section 362(c)(3)(A).[15]

Thus, any party in interest, including other creditors harmed by the debtor's bad faith repeat filing, can seek an extension of the stay to protect valuable property rights (i.e., property with equity that could be available for distribution to unsecured creditors).

The BAP's opinion in Reswick adopts an interpretation of Section 362(c)(3)(A) which is consistent with congressional intent to prevent abusive bankruptcy filings. Reswick adds teeth and meaning to Section 362(c)(3)(A) which has been effectively written out of the Bankruptcy Code by the current prevailing majority interpretation.

As future courts continue to wrestle with the language of Section 362(c)(3)(A), courts should consider the BAP's well-reasoned opinion in Reswick and construe the statute in a manner consistent with Congressional intent to discourage bad-faith repeat filings.

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[1] In re Reswick Jr., __ B.R. __, 2011 WL 612728, at *10 (B.A.P. 9th Cir. Feb. 4, 2011).

[2] While the great majority of bankruptcy cases do not involve multiple bankruptcy filers who abuse the bankruptcy process, there is a growing and alarming trend of debtors who file multiple bankruptcy cases (or transfer partial interests in real property) on the eve of foreclosure, without having any ability or intention of restructuring or repaying their secured obligations.

[3] Growth in Bankruptcy Filings Slows in Calendar Year 2010, available at: www.uscourts.gov/News/NewsView/11-02-15/Growth_in_Bankruptcy_Filings_Slows_In_Calendar_Year_2010.aspx.

[4] 2009 Report of Statistics Required by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, available at: www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BAPCPA/2009/2009BAPCPA.pdf.

[5] 109 H. Rpt. 31 (2005).

[6] *Id.*

[7] Reswick, 2011 WL 612728 at *8.

[8] *In re Daniel*, 404 B.R. 318, 321 (Bankr. N.D. Ill. 2009).

[9] See Reswick, 2011 WL 612728 at *3 (and cases cited therein).

[10] *In re Holcomb*, 380 B.R. 813, 816 (B.A.P. 10th Cir. 2008).

[11] Reswick, 2011 WL 612728 at *8.

[12] *Id.* at *5.

[13] Even before the enactment of the BAPCPA, bankruptcy courts recognized the growing problem caused by serial bankruptcy filers. In many instances, a debtor would transfer a fractionalized interest in property on the eve of foreclosure to a person who would then file bankruptcy. Therefore, instead of having to move for relief from the automatic stay in one bankruptcy case, a creditor would be forced to move for relief from stay in multiple bankruptcy cases to avoid possible sanctions for violation of the automatic stay. This type of bankruptcy abuse had the effect of delaying foreclosure for many months. In response to these abusive bankruptcy filings, courts began entering “in rem” orders that lifted the automatic stay to enable a secured creditor to foreclose on the property regardless of whether the property was subsequently transferred to a third party, or a new bankruptcy petition was filed. These “in rem” orders are now commonplace in many jurisdictions.

[14] Reswick, 2011 WL 612728 at *8; see also 11 U.S.C. § 362(c)(4) (providing that no stay shall go into effect upon the filing of the third bankruptcy case within one year).

[15] *Id.* at *5.