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Debtors' **Delusions** of Bankruptcy

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Bankruptcy is intended to provide debtors with the opportunity of a fresh start by modifying their debt obligations, but the downturn in the economy and the real estate market has spurred a number of filings that can only be described as desperate bankruptcy petitions filed by entities hoping for a "miracle." See *In re RYYZ*, 490 B.R. 29, 33-34 (Bankr. E.D.N.Y. 2013). While not every case can be successfully restructured, despite the good intent of many debtors, filings must still be made in good faith.[1] However, these baseless and ultimately futile bankruptcy filings continue to occur despite the previous attempts by Congress to set some parameters and minimize the misuse of the reorganization process.[2]

Several cases that have crossed the undersigned's path (directly or by word of mouth) have simply been remarkable wastes of time for our judiciary and generated unnecessary legal fees that needed to be paid by the creditors. These examples manifest at their core a misunderstanding of how the process should work and when bankruptcy truly can assist a debtor. What follows is a highlight of just a few cases that demonstrate how the failure to appreciate the law and the impact of a filing can lead to nothing more than delay, wasted resources and, at times, disaster for the debtor.

In late 2012, a filing took place in New Jersey by a debtor that owned no assets in New Jersey,[3] and instead owned (at best) an interest in a right to redeem 13 parcels of land located in the Midwest for which the local county tax authority held the tax deeds to the parcels and was the legal owner of the same. See *In re Plover Development*, Bankruptcy Case No. 12-35579, District of New Jersey (Newark). There were no other real creditors in the case. Undoubtedly, it was the impending expiration of the redemption period (governed by state statute)—as opposed to an honest intent and genuine belief that a restructuring under Chapter 11 of the Bankruptcy Code was likely—that precipitated the debtor's filing of that case. The redemption period for 10 of the parcels was set to expire on the date of the filing of the bankruptcy case and the redemption period for the remaining three parcels was set to expire a short time thereafter. By virtue of Bankruptcy Code §108(b)(ii), a short extension of two months of the first redemption period was effectuated, while the remaining three parcels maintained the original redemption date (under Bankruptcy Code §108 it is the *later* of the time periods). However, for some unknown reason the debtor never even attempted to work within these deadlines, instead they filed an order to show cause to effectuate a sale of the property, but all of the hearings were scheduled after all of the original and extended redemption periods had expired.[4] Arguably, once the

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period expired, the county could no longer even accept payment for the parcels under the state statute.

In *Plover Development*, the debtor's only saving grace was that, based upon the representation that the debtor had a buyer that would pay the full redemption amount, the Bankruptcy Court offered the debtor a few days respite to consummate the sale (which admittedly would have been to the benefit of the creditor). Unfortunately, this deadline also came and no deal transpired. The case was then dismissed by the Bankruptcy Court after the automatic stay was lifted to allow the tax sale to go forward. (The Order even further provided in rem relief protecting the parcels from further filings). The Bankruptcy Court recognized that keeping this two party dispute in bankruptcy served no viable purpose and the case was a bad faith filing. See *Y.J. Sons & Co. v. Anemone (In re Y.J. Sons & Co.)*, 212 B.R. 793, 802 (D.N.J. 1997), citing *In re Phoenix Piccadilly*, 849 F.2d 1393, 1394-95 (11th Cir. 1988). The money spent on the filing was a complete waste as it accomplished nothing (in fact anything that could have been achieved could have been accomplished outside of bankruptcy). The debtor and/or its counsel completely and utterly failed to recognize any of the key deadlines, burdens or other obligations and lost any ability to save the parcels in the end.

Similarly, there was a recent filing in the Eastern District of New York, in the case of Hun Mi Kim and Chung Sam Kim, Case No. 13-75368. This filing was intended to save real estate purportedly occupied by the individual debtors who had been fighting an ongoing state court foreclosure process. On the eve of the foreclosure sale, the debtors filed for bankruptcy to stop the sale. Remarkably, a review of the petition and schedules revealed an acknowledgment by the debtors that they had actually transferred their ownership interest in the property to a third party (a company designed to help "save" property from foreclosure) months before the filing. Although stay relief was sought as the owners were named in the underlying foreclosure action, the debtors were unable to stop the foreclosure process as they had divested themselves of any ownership interest in the property; thus, even assuming that they had the ability to try to save the property financially, they no longer had an equitable or legal ownership right in the property.[5] Moreover the third-party "savior" having taken the property during the course of the foreclosure action after a lis pendens had been filed could not act as a bona fide purchaser and would be wiped out in the foreclosure action.[6] Had the debtors kept the property and actually sought to use the loss mitigation process they might have had a chance to save the property. The misguided bankruptcy filing cost the lender a few weeks of time, certainly the debtor's money, but secured finality to the process.

Sometimes filing for bankruptcy becomes a debtor's worst nightmare, not because the bankruptcy filing doesn't give them relief, but because the filing gives the creditors a forum to deal with an ongoing problem. In the case of *Owner Management Service*, 1:12-bk-10231-MT, pending in the Central District of California, the debtor was engaged in a rent skimming operation. The debtor would find distressed borrowers, convince them to transfer title of the real property into a trust to save the property. Many times the borrowers would move out, so the debtor would rent the properties to third parties setting up trusts for real estate properties but it would keep the rental stream and not service the mortgages. The principals that controlled this debtor also controlled several other entities all engaged in the same kind of schemes.[7] Once the debtor was no longer able to stall through the short sale process, it would file a complaint against the bank for foreclosure irregularities as nothing more than another stall tactic. The end result was long delays of the foreclosure actions.

About two years before the filing, a disgruntled tenant obtained a judgment for $60,000 for the advance rent that he had paid for a house that was foreclosed upon during his tenancy. The tenant obtained a lien against one of the debtor's bank accounts. In an effort to "outsmart" the tenant, the debtor filed this one entity into Chapter 11 to try to avoid the lien and then intended to dismiss the case. The creative lender instead pushed for the case to be converted to Chapter 7 and a trustee appointed. Then the lender removed all the related litigations to the bankruptcy court. The debtor is now stuck in the federal forum, and a multitude of their related entities are being dragged into the process. Had the debtor's counsel truly appreciated the implications of their "simple filing," they never would have filed the case and the downside of the gamesmanship.

Lastly there were a series of bankruptcy filings in the Bankruptcy Court of the Southern District of New York all intended to "save" an operating business. In an effort to stall the pending foreclosure processes (there were two separate cases as there were two adjacent parcels of land), the owner managed to file over the course of four years, no less than five filings in an effort to stop the process and continue to skim money from the business. The successive filings were by different entities (the owner of the adjacent parking lot, the landlord, the operating tenant, the principal and then, again, the operating tenant) and caused significant delay in the ability of the various lenders to recover their respective properties. Moreover, some of the delay was created by the intentional failure of the principal to identify the prior affiliates filing causing, in some cases, the new debtor to be assigned to different judges.[8] Quick and proactive thinking by counsel resulted in the transferring of all cases as they filed to the same judge but additional delay was encountered. After relief from the stay was granted in each case to allow the foreclosure processes to continue, the case was dismissed as a bad faith filing. See, e.g., *In re Loco Realty*, No. 09-11785 (AJG), 2009 Bankr. LEXIS 1724 at * 10 (Bankr. S.D.N.Y. June 25, 2009) ("The 'critical test of a debtor's bad faith remains whether on the filing date there was no reasonable likelihood that the debtor intended to reorganize and whether there is no reasonable possibility that the debtor will emerge from bankruptcy,'" quoting *In re 68 West 127 Street*, 285 B.R. 838, 846 (Bankr.

S.D.N.Y. 2002)); see *Gen. Motor Inns v. L&M Props., (In re L&M Props.)*, 102 B.R. 481, 484 (Bankr. E.D. Va. 1989); *CMF Loudoun P'ship v. Nattchase Assocs. P'ship (In re Nattchase Assocs. Ltd. P'ship)*, 178 B.R. 409, 418 (Bankr. E.D. Va. 1994); see also *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest*, 484 U.S. 365, 375-76 (1988) (noting that the Bankruptcy Code does not merely require that certain property be necessary or needed for an effective reorganization, but that the "property is essential for an effective reorganization *that is in prospect*"). Thus any delay was short lived and without any meaningful result.

However one mistake that the principal made in approaching the process in tranches as opposed to a singular filing was that, had all of the entities filed at the same time, there might have been a real likelihood that the fees and expenses wasted on the delay tactics could have been invested into the process to perhaps effectuate a real consolidated plan. So too, the debtor would have been able to show the existence of a multitude of assets and debts that needed time to reorganize not just a two-party dispute. In the end, as a final desperate measure to avoid eviction in landlord-tenant court, the debtor "sold" the operating business to a third party and then, for reasons unbeknownst to anyone, filed for Chapter 7 for the transferring entity. Given the delays that would have existed in landlord tenant court, this decision only expedited relief for the creditor; by bringing this entity and its "assets" back before the same bankruptcy judge who was quite familiar with the history of the case, the debtor allowed the lender to identify the sale for the sham it was, get hard and fast relief from the bankruptcy judge against all parties including the alleged purchaser and actually carry out an eviction using the federal marshals on an expedited basis within the bankruptcy forum. While time was lost as a result of some of the delays, the ability to finally achieve closure was rewarding to say the least.

While filing a case as a litigation tactic is not necessarily prohibited if reorganization is possible, see *Fraternal Composite Servs. v. Karczewski*, 315 B.R. 253, 256 (N.D.N.Y. 2004); *In re Schur Mgmt.*, 323 B.R. 123, 130 (Bankr. S.D.N.Y. 2005), courts have no tolerance for debtors who file for the stay but do little else. *In re 652 W. 160th*, 330 B.R. 455 (Bankr. S.D.N.Y. 2005) (finding the case should be dismissed where after the petition was filed, the debtor then proceeded to administer its case in a manner in which statutory deadlines were missed, false creditors were created and paid and false operating reports were filed).

Finally, it should be noted that debtors cannot avoid the consequences of the bad advice of their lawyers. The Supreme Court has held that "each party is deemed bound by the acts of his lawyer-agent and is considered to have 'notice of all facts, notice of which can be charged upon the attorney.'" *Link v. Wabash R.*, 370 U.S. 626, 634, 82 S. Ct. 1386, 1390, 8 L. Ed. 2d 734, 740 (1962); *Pioneer Inv. Servs. v. Brunswick Assocs. Ltd. P'ship*, 507 U.S. 380, 396, 113 S. Ct. 1489, 1499, 123 L. Ed. 2d 74, 90 (1993); *Lewis v. Weyerhaeuser*, 141 Fed. Appx. 420, 427-28 (6th Cir. 2005) (holding that the appellant "presents no compelling reason to justify departing from the general rule set forth in Link that litigants are bound by the actions of their attorneys"). Therefore, when a party voluntarily chooses an attorney as his representative in the action, he or she "cannot now avoid the consequences of the acts or omissions of this freely selected agent." *Link*, 370 U.S. at 633-34; see also *In re DePugh*, 409 B.R. 84, 106 n.13 (Bankr. S.D. Tex. 2009) (noting that a debtor is bound by the acts of his lawyer-agent). Since "bad legal advice does not relieve the client of the consequences of her own acts… . The remedy for bad legal advice lies in malpractice litigation against the offending lawyer." *Cannon-Stokes v. Potter*, 453 F.3d 446, 449 (7th Cir. 2006); see also *In re Gow Ming Chao*, No. 11-38131, 2011 Bankr. LEXIS 4543, at *24-25 (Bankr. S.D.N.Y. Nov. 21, 2011) (when the court found that while the attorney failed to properly advise the debtors of their obligations to comply with the requirements set forth in the Bankruptcy Code, the Federal Bankruptcy Rules, the Bankruptcy Local Rules, and the U.S. Trustee Guidelines regarding their Chapter 11 case, their failure still supported the court's decision to convert their case to Chapter 7).

Bankruptcy can be a powerful tool that effectively brings relief to certain debtors when it is properly used. Unfortunately, the system remains vulnerable to misuse and can produce numerous and costly delays to the entire process even if final relief isn't viable. Those who don't properly use the tools afforded by the Bankruptcy Code or remain ignorant of the law should tread carefully. Judges and creditors have very little patience for these filings and the overall trend is to dispose of cases that represent a waste of time.

1. See *C-TC 9th Ave. P'ship v. Norton Co. (In re C-TC 9th Ave. P'ship)*, 113 F.3d 1304 (2d Cir. 1997).

2. See, e.g., Bankruptcy Code §362(d)(3) enacted in 1994 was intended to fast track single asset real estate cases (defined in Bankruptcy Code §101(51B)); this section "compels debtors to act swiftly be obligating then to fulfill one of two mandates by 'not later than the date that is 90 days after the' petition date." See *RYYZ*, at 29.

3. Venue in New Jersey was predicated on the fact that the debtor was a New Jersey entity. See 28 U.S.C. §1408.

4. It should be noted that as far as we are aware there is no ability to extend the deadline under Bankruptcy Code §108. Prior attempts to extend this time frame using the Bankruptcy Court's equitable powers under Bankruptcy Code §105 have been soundly rejected. Specifically, this issue has been addressed by the District of New Jersey wherein the court held that absent exceptional circumstances, the equitable power given to the Bankruptcy Court under Bankruptcy Code §105 would be insufficient to enlarge a debtor's property rights beyond those specifically set forth by state law and by Congress under §108(b). *In re Lawrence & Paget Berger (In re Berger)*, No.: 12-24891 (MBK), 2012 Bankr. Lexis 5570, at *4-8 (Bankr. N.J. Nov. 29, 2012), citing *In re 210 Roebling*, 336 B.R. 172, 176 (Bankr. E.D.N.Y. 2005); *In re Glenn*, 760 F.2d 1428, 1441 (6th Cir. 1985); *Johnson v. First Nat'l Bank of Montevideo Minn.*, 719 F.2d 270, 274 (8th Cir. 1983); *In re Farmer*, 81 B.R. 857, 862 (Bankr. E.D. Pa. 1988).

5. Bankruptcy Code §541 defines "property of the estate" to include "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541. It is well-settled that bankruptcy courts must look to state law to determine whether an asset is "property of the estate." See *Butner v. United States*, 440 U.S. 48, 55 (1979).

6. New York courts have held that "a person whose conveyance is recorded after the filing of the notice [of pendency] is bound by all proceedings have taken in the action after such filing to the same extent as a party." *Green Point Sav. Bank v. St. Hilaire*, 267 A.D.2d 203, 203 (N.Y. App. Div. 2d 1999).

7. This debtor's foreclosure prevention and/or delay tactics stretched back until at least 2007, see, e.g., *In re Mi La Sul*, 380 B.R. 546 (Bankr. C.D. Cal. 2007), and a review of public records indicated that since at least 2007, the debtor had filed approximately 121 lawsuits against various mortgage lenders, trustees, and loan investors that were conducting non-judicial foreclosures on residential properties.

8. See Page two of voluntary petition requiring disclosure of any affiliates. The word affiliate is defined by Bankruptcy Code §101(2) which includes, inter alia, corporations for which twenty percent or more of their stock is owned or controlled by the same person directly or indirectly.