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LITIGATION STRATEGIES

COURT SETTLES MEANING OF 'WITH RESPECT TO THE DEBTOR' IN SERIAL-FILING DEBTORS' CASES

By Scott H. Bernstein and Andrew K. Stutzman

Scott H. Bernstein and ***Andrew K. Stutzman*** are members of the consumer financial services group at *Stradley Ronon Stevens & Young*. Bernstein, counsel in the New York City office with significant creditors' rights and bankruptcy experience, can be reached at *sbernstein@stradley.com*. Stutzman, a partner in the Philadelphia office and the group's co-chairman, can be reached at *astutzman@stradley.com*.

Bankruptcy filings continue unabated. Through November last year, there were over 700,000 new filings for the eleven months of 2018. *See* American Bankruptcy Institute, November 2018 Bankruptcy Statistics: abi.org/newsroom/bankruptcy-statistics. Although this volume slightly declined from the previous year, filings like these demonstrate the importance of bankruptcy issues to those, including creditors, involved in consumer financial services litigation.

Given that, the impact of 'serial filers' and the breadth of the automatic stay arising from those cases has been a 'hot button' issue that has largely been unsettled. Now, an appellate court has finally spoken on the issue.

The breadth of the problem

A debtor's bankruptcy petition usually stays all collection activity involving the debtor, the debtor's property, and property of the bankruptcy estate pursuant to Section 362(a) of the Bankruptcy Code. (*See* 11 U.S.C. § 362(a).) However, the application of the automatic stay to bar creditors' collection actions in cases of serial-filing debtors has been unsettled.

This is so despite Congress's 'decades-long focus on repeat bankruptcy filers.' (*See* Sara Sternberg Greene, 'The Failed Reform: Congressional Crackdown on Repeat Chapter 13 Bankruptcy Filers,' *Am. Bankr. L.J.*, Vol. 89 at 245 (2015).) Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 to address the serial filer problem. (*See* Pub. L. No. 109-8, 119 Stat. 23 (2005). *See also* H.R. Rep. No. 31, at 2 (2005).)

The heart of the BAPCA's reforms includes provisions intended to deter serial and abusive bankruptcy filings. To that end, BAPCPA added § 362(c)(3)(A) to the Bankruptcy Code, which says that:

> ... if a single or joint case is filed by or against a debtor who is an individual in a case under

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> chapter 7, 11, or 13, and if a single or joint case of the debtor was pending within the preceding 1-year period but was dismissed ... the stay ... 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.'

Before the end of the 30-day period, a bankruptcy court "may extend the stay" pursuant to § 362(c)(3)(B) if the debtor or a creditor shows "that the filing of the [second] case is in good faith."

Courts adopt 'majority view'

Courts have split on the extent to which the automatic stay terminates under § 362(c)(3)(A). One line of authority, often referred to as the "majority view," limits the effects of the termination of the automatic stay to only allow creditors' actions against the debtor personally and property that is not property of the estate under § 541. (*See, e.g., Holcomb v. Hardman (In re Holcomb)*, 380 B.R. 813 (B.A.P. 10th Cir. 2008).)

The vast majority of the debtor's pre-bankruptcy property becomes estate property on the filing of a bankruptcy petition. (*See* 11 U.S.C. § 541(a); *see also Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992), which held that '[w]hen a debtor files a bankruptcy petition, all of his property becomes property of a bankruptcy estate.'

In the Chapter 13 context and unlike Chapter 7, the definition of estate property includes most property and wages that the debtor acquires post-filing. (*See* 11 U.S.C. § 1306; *see also In re Jupiter*, 344 B.R. 754 (Bankr. D.S.C. 2006), finding that, "[i]n a chapter 13 setting, property of the estate encompasses nearly all of a debtor's valuable assets pursuant to § 1306."

Therefore, a termination of the stay for non-estate property provides little benefit to creditors since that property is almost always unprotected by § 362(a) in the first place. (*See In re McClellan*, 45 F.3d 432 (7th Cir. 1995), holding that "[b]ankruptcy courts do not have subject matter jurisdiction over property excluded from or outside the bankruptcy estate.")

Moreover, non-estate property often falls into three categories that likewise offer little value to creditors:

- Property abandoned by the trustee because it is unduly burdensome or of inconsequential value under § 554(a) (*i.e.*, property lacking a value that could be monetized).
- Exempt property that is often protected from creditors' claims under state law and, therefore, not available to satisfy creditors' judgments.
- Property that does not pass to the estate upon commencement of the case — which in the context of a Chapter 7 case is post-bankruptcy earnings and acquisitions.

In sum, there is little to no property that is both non-estate property and of interest to creditors. Hence, the 'majority view' effectively eviscerates § 362(c)(3)(A).

Some courts have adopted 'minority view'

The second line of authority is often referred to as the "minority view." These decisions hold that the automatic stay terminates in its entirety under § 362(c)(3)(A). This means that the automatic stay no longer protects the repeat-filing debtor or any of that debtor's property, including property of the debtor's bankruptcy estate. (*See, e.g., In re Goodrich*, 587 B.R. 829 (Bankr. D. Vt. 2018).)

The minority view is the only view that makes sense to a creditor in the Chapter 13 context, where the serial-filing problem is most prevalent. There, Chapter 13 debtors remain in possession of, have full use and enjoyment of, and generally fund their plans with estate property. This generally includes assets acquired by the debtor after the bankruptcy petition's filing, including post-petition income. (*See* 11 U.S.C. § 1306(b).)

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Indeed, the majority view makes § 362(c)(3)(A) toothless in a Chapter 13 bankruptcy because of the breadth of the Chapter 13 estate. *In re Jupiter*, for example, held that: "A creditor's threat to collect would be hollow if the stay remained as to property of the estate because ... § 1306 broadly incorporates all of a debtor's valuable pre- and post-petition property."

At last, some guidance in the long battle

This battle between two views of the scope of a stay termination under § 362(c)(3)(A) for serial filers has raged in bankruptcy courts since the enactment of BAPCPA in 2005. Recently, however, guidance has emerged from an appellate court on the issue.

The 1st U.S. Circuit Court of Appeals, in *Leland S. Smith, Jr. v. State of Maine Bureau of Revenue Services (In re Leland S. Smith, Jr.)*, No. 18-573, 910 F.3d 576 (1st Cir. Dec. 12, 2018), addressed the breadth of termination of the automatic stay under § 362(c)(3)(A). In doing so, the panel adopted the 'minority view.' It held that when the stay terminates 'with respect to the debtor' pursuant to § 362(c)(3)(A), the stay terminates in its entirety, ceasing to protect the repeat-filing debtor and all of the debtor's property, including property of the debtor's estate.

Leland Smith Jr. had filed for Chapter 13 bankruptcy in 2011. His case was dismissed in 2014 after he failed to make payments under a Chapter 13 plan. Smith quickly filed for Chapter 13 again that same year. The second case was dismissed in November 2016, after he failed to make payments required under a confirmed Chapter 13 plan.

In December 2016, Smith filed a third case under Chapter 13. In both of the Chapter 13 cases that were pending in 2016, Smith owed about $200,000 to creditors, mostly the Internal Revenue Service and the Maine Bureau of Revenue Services.

A bankruptcy court eventually confirmed a Chapter 13 plan in the third case, which required Smith to pay $800 per month to a Chapter 13 trustee who would in turn make payments to Smith's creditors. While Smith's Chapter 13 plan was being considered, MRS and Smith disputed the scope of the termination of the automatic stay under § 362(c)(3)(A).

Neither Smith nor another "party in interest," like a creditor, had moved "for continuation of the automatic stay," as allowed under § 362(c)(3)(B). As a result, by Jan. 27, 2017, 30 days after the filing of his Dec. 28, 2016 petition, the automatic stay terminated under § 362(c)(3)(A).

At a bankruptcy court hearing, MRS argued that § 362(c)(3)(A) had terminated the automatic stay in full on Jan. 27, 2017. Smith opposed, and claimed that the phrase 'with respect to the debtor' meant that the stay terminated on Jan. 27 only as to actions against the debtor and the debtor's property, not as to actions against the property of the bankruptcy estate.

The bankruptcy court ruled that the automatic stay had terminated in full, including as to property of Smith's bankruptcy estate. The district court affirmed. Smith appealed to the Court of Appeals.

Statute ambiguous, but...

After examining the text of the statute, the 1st Circuit appellate panel concluded that § 362(c)(3)(A) is ambiguous and that a strict application of the cannons of interpretation would be unhelpful, but that its language should be construed broadly. The panel then examined the legislative history of BAPCPA and its precursor legislation, a proposed amendment to the Bankruptcy Code considered by Congress in 1998 that contained a section that was 'essentially identical' to § 362(c)(3)(A). The panel determined that the automatic stay terminates completely after the 30-day period and not just "with respect to the debtor."

The panel reviewed the legislative history of BAPCPA, finding evidence there that the provision was designed to "discourag[e] bankruptcy abuse, and in particular, to discourag[e] bad faith repeat filings — that is, filing for the benefit of triggering the automatic stay, rather than some valid reason." For that reason, the panel determined that the congressional "purpose is best achieved by interpreting § 362(c)(3)(A) to terminate the entire stay, including as to estate property. The portion of the stay that is most valuable to a bankruptcy petition, just as a creditor, is the portion that protects estate property."

The panel found further evidence of this legislative purpose in BAPCPA's precursor legislation. Congress drafted the earlier legislation based in part on a 1997 report by the National Bankruptcy Review Commission that highlighted the problem of debtors "fil[ing] for chapter 13 ... on the eve of a foreclosure or eviction for the sole purpose of delaying the state legal process. When the threat passes, they dismiss their cases, only to file again when the mortgagee or landlord brings another legal action to seize control of the property.'

The appellate panel found that this concern — abuse of the automatic stay, especially in Chapter 13 cases — animated the never-enacted precursor to § 362(c)(3)(A). In 1998, Congress attempted a reform of the Bankruptcy Code, including an amendment that was "essentially identical" to § 362(c)(3)(A).

The amendment aimed to reduce abuses of the bankruptcy system by reducing the incentive to file for bankruptcy repeatedly without completing the bankruptcy process. As the 1998 House report described: "Some debtors file successive bankruptcy cases to prevent secured creditors from foreclosing on their collateral. [The change to the automatic stay] remedies this problem by terminating the automatic stay in cases filed by an individual debtor ... if his or her prior case was dismissed within the preceding year."

Therefore, "[b]ased on the provision's text, the statutory context, and Congress's intent in enacting [BAPCPA]," the appellate panel embraced a broad termination of the automatic stay under § 362(c)(3)(A). Specifically, the court held that "§ 362(c)(3)(A) terminates the entire automatic stay — as to actions against the debtor, the debtor's property, and property of the bankruptcy estate — after 30 days for second-time filers."

The appellate panel entered judgment on Dec. 12, 2018, and issued its Mandate on Jan. 2, 2019, following expiration of the time to request rehearing. Consequently, this ruling is now binding upon the bankruptcy and district courts of Maine, Massachusetts, New Hampshire, Rhode Island, and Puerto Rico.

How this decision is significant

This decision establishes a bright-line rule for creditors in cases within the 1st U.S. Circuit Court of Appeals. Now, such creditors may pursue action to collect estate property following the termination of the automatic stay under § 362(c)(3)(A).

Consistent with that broad stay termination, such creditors are freed from claims for a stay violation under § 362(k)(1), which allows 'an individual injured by any willful violation of a stay' to sue and 'recover actual damages.' While the decision only controls cases within the 1st Circuit, it may resonate with courts in other circuits, especially those bankruptcy courts in the 2d, 3d, 4th, and 10th Circuits that have traditionally followed the "majority view."

In similar circumstances, this decision may be supply persuasive authority to other courts that will address the issue. Likewise, courts might reconsider the continuing viability of earlier decisions that barred collection activity in certain serial bankruptcy cases.

The reasoning of the 1st Circuit affirms that Congress intended a broader termination of the automatic stay when it enacted BAPCPA to address and deter serial filers, and to protect the rights of creditors.

