ESCAPING FROM THE AUTOMATIC STAY?*

** by Bruce J. Bergman

The lending community and their counsel well recognize that the filing of a petition in bankruptcy imposes an automatic stay upon a foreclosure action. But what if the debtor (the borrower) didn't list the mortgage holder as a creditor in its filing (so that the mortgagee didn't know about the bankruptcy) and what if the resultant continuation of the foreclosure did not prejudice the debtor-borrower? Would those factors be sufficient for the state court where the foreclosure was pending to allow the foreclosure prosecuted during the stay to be valid? Yes, said a trial court in New York, no said the appeals court. [*Carr v. McGriff*, 8 A.D.3d 420, 781 N.Y.S.2d 34 (2d Dept. 2004)].

From the viewpoint of a mortgage lender or server, the trial court opinion was welcome and seemingly reasonable. Why it was overturned on appeal, though, was understandable. The facts and applicable law tell the story, at the same time offering a helpful primer on the sometimes perplexing rules of bankruptcy as they relate to a defaulted mortgage.

Lender began a foreclosure (upon a second mortgage) on November 2, 1995. Borrower, a one-half owner of the property, was personally served a few days later but defaulted in the action and so the case proceeded eventually to issuance of a judgment

** Mr. Bergman, author of the three volume treatise, *Bergman on New York Mortgage Foreclosures*, Matthew Bender & Co., Inc. (rev. 2006), is a partner with Berkman, Henoch, Peterson & Peddy, P.C. in Garden City, New York, a member of the USFN and an Adjunct Associate Professor of Real Estate with New York University's Real Estate Institute where he teaches the mortgage foreclosure course. He is also a member of the American College of Real Estate Lawyers and the American College of Mortgage Attorneys.

of foreclosure and sale in September of 2001. What the foreclosing plaintiff never knew was that back in March, 1996 the borrower filed a Chapter 13 petition, although that was dismissed in August, 1997. But a second Chapter 13 petition was filed in late October, 1997 with the plan confirmed and later completed, leading to a bankruptcy court discharge in November, 2002.

By February, 2003 the borrower moved to vacate the referee's appointment, the computation and the judgment, all on the grounds that each issued in violation of the automatic stay provision of the Bankruptcy Code. In denying the borrower's motion to vacate the various foreclosure stages, the state trial court concluded that the acts violative of the stay were not void, but merely voidable – an important distinction. It also ruled that continuation of the foreclosure during the stay imposed by bankruptcy filings did not prejudice the borrower and so should be allowed to stand.

In its reversal, these succinct points made by the Second Department highlight the applicable law:

- The bankruptcy code provides for an automatic stay of certain prescribed actions against a debtor's property (11 U.S.C. §362[a]).
- Imposition of the automatic stay is one of the fundamental protections afforded a debtor by the Bankruptcy Code.
- The stay is effective immediately upon the filing of a petition without need for further action.
- The stay is not limited to the litigants, but rather extends to a non-bankruptcy court too so that the stay serves to suspend any non-

bankruptcy court authority to continue any judicial proceedings which are then pending against that debtor.

- Proceedings which the Bankruptcy Code stays upon a petition filing are void if they take place after the stay begins. (Ministerial acts such as entering a judgment is not barred, but issuance of a decision by a state court judge is.)

While an action violative of a stay is void, power to validate the action is given to the bankruptcy court itself (but not the state court). As a matter of law, the bankruptcy court can terminate, annul or modify the automatic stay. Here then, the foreclosure steps taken in state court were simply of no effect. The bankruptcy court could have ratified those, but it did not. State court in effect annulled the bankruptcy stay from the inception – a power it just did not have.

It may very well be that the borrower here suffered no prejudice by the foreclosure going forward even though a bankruptcy petition had been filed. And one could argue rationally that a stay should not be imposed upon a lender who is never mentioned in the bankruptcy case and never given any notice whatsoever of the existence of the bankruptcy filing – particularly since the uninformed lender is likely to spend much time and money endeavoring to enforce its rights, blissfully unaware of any impediment to continuing. But law is to the contrary.