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"In Rem" Relief from Stay

Affords relief from serial bankruptcies for real estate lenders

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Almost nothing frustrates a real estate lender more than being unable to timely enforce its deed of trust through foreclosure. When the borrower files bankruptcy, the "automatic stay" of Section 362 of the Bankruptcy Code, at least temporarily, prevents the lender from completing its foreclosure. Notwithstanding that the borrower's bankruptcy may have been filed solely for the purpose of hindering or delaying the foreclosure, to complete the foreclosure, the lender needs to make a motion to the court for relief from the automatic stay. Obtaining relief from stay can take months and cost many thousands of dollars for legal fees, appraisal costs and the like as the lender must establish its entitlement to relief from stay. However, even though the lender may be successful in obtaining relief from stay granted by the court in the borrower's bankruptcy, it still may not be clear sailing through foreclosure. All too often the borrower is unwilling to give up without a further fight. In those situations, the borrower may transfer the property, or an interest in or a lien upon the property, to a related or friendly third party (often formed for just that purpose) which in turn files another bankruptcy to gain the benefit of the automatic stay and forestall the foreclosure.

Bankruptcy courts have also observed another pattern of cases, in which a borrower, who is not a debtor in bankruptcy, attempts to stave off foreclosure by purporting to transfer an interest in his or her property to a debtor in bankruptcy. Usually, the borrower and the debtor have no connection. The original borrower, or someone working on the borrower's behalf, may have found the Debtor's name by simply searching public bankruptcy records. The borrower may have falsified and back-dated a grant deed, and the deed may have never been actually recorded. In such cases, the only party who truly benefits from this scheme is the original borrower who obtains the automatic stay in the bankruptcy case of another party without having to file a bankruptcy petition and comply with the requisite duties of a debtor in bankruptcy. (*See, e.g., In re Dorsey*, 476 B.R. 261, 266 (Bankr. C.D. Cal. 2012).

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Schemes like the scenarios described above can forestall foreclosure for, in the case of some crafty borrowers, several years. Thus, in either of these scenarios, the lender is back at square one and is now truly frustrated. Fortunately, there is now some relief for lenders.

In recognition of the potential for such "serial bankruptcies," Section 362(d)(4) was added to the Bankruptcy Code in 2005 as part of the Bankruptcy Abuse Prevention and Consumer Protection Act. Section 362(d)(4) was added to combat serial bankruptcy filings by allowing an "in rem" relief from stay order. Such an order, once a certified copy is recorded in the real estate records with regard to a specified property, makes the relief from stay order effective for 2 years in most cases regardless of any subsequent bankruptcy filing within that 2 year period. The "in rem" relief from stay is both prospective and automatic for the 2 year period. Consequently, the "automatic stay" otherwise applicable upon the filing of a bankruptcy does not take effect, and the lender is permitted to continue and complete its foreclosure notwithstanding the subsequent bankruptcy filing. To thereafter circumvent the "in rem" relief, a debtor would be required to seek the bankruptcy court's reconsideration of the "in rem" relief order and carry the burden of proving a material change in circumstances and/or good faith.

However, as originally enacted, Section 362(d)(4) was of little use to lenders as it required the lender to demonstrate that the bankruptcy filing was part of a scheme to delay, hinder *and* defraud creditors. Although delay and hinder are fairly obvious and easily demonstrated, fraud is much more difficult to prove often requiring extensive discovery and factual presentation. As all 3 elements were required to be shown, the "in rem" relief offered by Section 362(d)(4) was infrequently sought and very rarely granted. Consequently, "in rem" relief from stay had fallen off the radar of most real estate lenders and their counsel.

Subsequently, as part of the Bankruptcy Technical Corrections Act of 2010, "and" was replaced by "or" in Section 362(d)(4) thus paving the way for much broader application of the "in rem" relief from stay provision. The burden of proof on the lender seeking "in rem" relief is now substantially reduced. All the lender need show is that there was a scheme to delay, hinder or defraud, and if that scheme involves the transfer of an ownership interest in real property without the secured creditor's consent, then the secured creditor may obtain relief under § 362(d)(4). The debtor's involvement in the scheme is not required. This post-2010 interpretation thus covers the second scenario described above in which the actual borrower is not actually the debtor in bankruptcy.

In summary, real estate lenders have a powerful but little known tool for combating actual or potential serial bankruptcy filings. By obtaining "in rem" relief from stay under the appropriate circumstances, the lender can avoid the need for costly and repetitive visits to the bankruptcy court in the process of enforcing its loan through foreclosure.