

Bankruptcy and The Motion For Relief From Stay

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When a delinquent owner files for bankruptcy relief by filing a petition under either Chapter 7 or Chapter 13 of the United States Bankruptcy Code, the Code provides that an automatic stay, subject to certain exceptions, is immediately put into place. An automatic stay is like a restraining order, and it happens as soon as the bankruptcy is filed. This “stay” applies to creditors, including the association to whom the owner owes money, and it means an association can no longer collect or even attempt to collect any money (or foreclose on the property) from the owner, at least without getting permission from the bankruptcy court. The stay is intended to protect the delinquent owners who file bankruptcy. All actions to collect the delinquent assessments must stop including lawsuits, foreclosures, as well as the suspension of membership and/or common area privileges.

What Is A Motion For Relief From Automatic Stay?

A Motion for Relief from Automatic Stay is a motion filed by a creditor, the association in this case, requesting that the bankruptcy court end the stay as to the particular creditor. If the Motion is granted, the automatic stay is lifted so that the creditor association can resume its collection action that it was pursuing prior to the filing of the bankruptcy case including the foreclosure of the property. The Motion for Relief from Automatic Stay can only be made by a secured creditor, which is another reason that associations should not delay in recording a lien.

If an association was in the process of foreclosure, the automatic stay stops that process. An order granting the association’s Motion for Relief from Automatic Stay allows an association to pick up where it left off.

The law regarding Relief From Automatic Stay is found in Sections 362(d) – (g) of the Bankruptcy Code and it provides a creditor association with methods and grounds for obtaining a bankruptcy court order for relief from the stay. Relief From Automatic Stay only applies to the creditor that filed a motion for it, and only for the activity described in the motion.

Forms of Relief — Termination, Annulment, Modification, and Conditioning

There are four (4) different types of relief from stay: termination, annulment, modification, and conditioning. A creditor association will usually be seeking modification.

Modification of the stay modifies the stay so that the creditor association can proceed with the foreclosure or a lawsuit. For instance, if the association was ready to foreclose, the Court will order that the association can proceed with the foreclosure. If the creditor association is involved in a court case seeking judgment for its claim, then the modification may allow the association to obtain

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the judgment, but not to allow the collection of the judgment. A creditor may want to do this to have the judgment so that it can proceed if the bankruptcy case is dismissed or if the debt is not discharged.

Annulment of the automatic stay may be necessary in a situation where the creditor association took action against the debtor/delinquent owner or the property while the debtor's bankruptcy was pending due to the association being unaware of the debtor's bankruptcy. For example, annulment would be necessary if the association's lien recorded while the debtor's bankruptcy was pending.

Grounds for Relief - There are several grounds for relief from the automatic stay. The most common grounds are for cause or because the debtor has no equity in the property, or it is not necessary for the debtor's reorganization in a reorganization bankruptcy (Chapter 11 or 13).

Relief from stay for acts against property is given if the debtor has no equity in the property and because it is not necessary for his reorganization. The 2nd condition only needs to be satisfied if there is equity in the property and if it is not a Chapter 7 bankruptcy since there is no reorganization in a Chapter 7 liquidation. With this ground for relief, the association creditor must prove that the debtor has no equity in the property.

If there is equity in the property and it is not a Chapter 7 bankruptcy, then it must be determined if the stay is necessary for the debtor's reorganization under a Chapter 11 or 13 plan. Property for the conduct of the debtor's business is the most common and obvious reason why property would be necessary for a reorganization. That obviously does not apply to a condominium or home, but it could apply in a commercial condominium or investment property, or perhaps by a delinquent owner that leases their unit or home.

Why Would A Community Association Want To Pay Attorney Fees For A Motion For Relief From Stay?

At this point you may be asking why an association would go through this process and incur the expense considering the fact that many, if not most, of the properties are under water and there is little likelihood that an association will recover money. Given that the bankruptcy may take some time to resolve, (i.e., 6 - 8 months for a Chapter or 3-5 years for a Chapter 13 Plan), most associations cannot or do not want to wait to foreclose until the bankruptcy case is closed. They want to get a paying owner in that unit or home.

Normally, during this period, the delinquent owners are not paying the post-

petition assessments. And lenders are not moving all that fast to foreclose. So many associations decide that they want and need to do something and usually that means foreclosure.

If the delinquent owner is not paying the post-petition assessments, before filing the Motion for Relief from the Automatic Stay, we would generally contact their attorney to see whether we can facilitate the delinquent owner's payment of the post-petition assessments. If the delinquent owner is not paying the post-petition assessments, then the association would have to file a Motion for Relief from Automatic Stay for relief before it can pursue the owner for the money or the unit/home itself through foreclosure for the non-payment of the post-petition assessments.

A Motion for Relief may be necessary to allow the association to proceed with the non-judicial foreclosure of the unit/home while the bankruptcy is pending in order to deal with the owner that has not paid (and continues to not pay) assessments and is living in the unit or home for "free". Most associations want to do what they can to get the non-paying owner out so that the unit/home will have new owners that will pay the assessments. If the association ends up with the unit or home at the foreclosure sale, the associations, in many cases, have been able to rent the property and collect rent pending foreclosure by the senior lender.

Keep in mind that pursuant to Civil Code Sections 1366 and 1367.1 and the association's CC&Rs, in addition to late fees, interest, collection costs, the association is entitled to recover its reasonable attorneys' fees and costs incurred by the association to collect the delinquent assessments from the debtor/delinquent owner. And this would include fees incurred for legal advice and the preparation of the Motion for Relief from Automatic Stay, which would be recoverable by the Association from the delinquent owner and the unit/home.

Questions regarding bankruptcy and motions for relief from stay? Contact David C. Swedelson at dcs@sghoalaw.com or Alyssa B. Klausner at abk@sghoalaw.com.