

Foreclosure After Property Has Been Abandoned by Bankruptcy Trustee May Violate Automatic Stay

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Under Section 554 of the Bankruptcy Code, a bankruptcy trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate. Once the trustee abandons an asset that serves as a secured lender's collateral, the lender may assume that it may proceed with foreclosure or repossession of the property since it has reverted back to the debtor. However, based on a recent decision from the Bankruptcy Appellate Panel ("BAP") for the Ninth Circuit this assumption is not only incorrect but may also give rise to contempt proceedings for violation of the automatic stay.

In *Gasprom, Inc. v. Fateh*, BAP No. CC-12-1567-KuKiTa (B.A.P. 9th Cir. filed October 28, 2013), the chapter 7 debtor had one significant asset—a non-operational gas station (the "Station"). The chapter 7 trustee decided to abandon the Station because she lacked the funds necessary to render it operational and because the Station was fully encumbered. The debtor objected to the abandonment claiming that there was equity in the Station. The bankruptcy court overruled the debtor's objection and authorized the abandonment. That same day, the secured lender (whose interest encumbered the Station) proceeded with foreclosure. After the bankruptcy case was closed, the debtor moved to reopen the case so that it could seek to set aside the foreclosure sale and hold the secured lender in contempt for violation of the automatic stay. The bankruptcy court agreed to reopen the bankruptcy case but held that the foreclosure did not violate the automatic stay because upon entry of the abandonment order, the automatic stay no longer enjoined the foreclosure sale of the Station. Therefore, the bankruptcy court refused to set aside the foreclosure or hold the secured lender in contempt for violating the automatic stay.

The debtor appealed the bankruptcy court's order to the BAP for the Ninth Circuit and the BAP held that the bankruptcy court erred when it held that the foreclosure sale did not violate the automatic stay. The BAP reached its holding by analyzing the effect of abandonment on the debtor's property and the various automatic stay provisions under Section 362 of the Bankruptcy Code.

Specifically, the court explained that upon abandonment, the Station was no longer property of the estate and title to the Station reverted back to the Debtor. As a result, the automatic stay provision that protects property of

the estate no longer applied. See 11 U.S.C. § 362(c)(1). However, the abandonment did not terminate the aspect of the stay arising from Section 362(a)(5), which protects "property of the debtor." As a result, abandoned property continues to be protected by the automatic stay to the extent it has reverted back to the debtor, unless and until the case is closed or dismissed, or a discharge is granted or denied.

Based on the foregoing reasoning, the BAP held that the bankruptcy court erred as a matter of law when it concluded that, immediately upon abandonment, the automatic stay no longer enjoined the foreclosure. Therefore, the BAP vacated the bankruptcy court's order and remanded for further proceedings consistent with its decision.

Lessons of Gasprom

The lessons of *Gasprom* highlight some of the potential pitfalls when interpreting and construing the effects of abandonment. Lenders must be wary of taking any action against property that has been abandoned in a bankruptcy case that is still open. More specifically, when in doubt, lenders should obtain assistance from bankruptcy counsel and seek relief from the automatic stay before taking any action against the property or risk being held in contempt for potentially violating the stay.

If you have any questions about the topics covered in this update, please contact a member of the Bankruptcy and Creditors' Rights group.

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