CONSUMER BANKRUPTCY

Do Foreclosure Defense Issues Belong in Bankruptcy Court?

By Craig D. Robins

Many homeowners who have been thrust into foreclosure understandably engage in a vigorous defense in state court — primarily in an effort to delay the inevitable foreclosure sale.

These homeowners often have a variety of potential defenses available to them, especially because many mortgagees engaged in a great deal of improprieties when the real estate market was especially hot about 10 to 15 years ago. Around that time, lenders had come up with the idea of packaging mortgages as securitized investments and selling them through financial institutions. However, the lenders often failed to properly prepare the paperwork or lost it, and sometimes backdated various documents.

When the real estate bubble burst in 2008, properties lost significant value and many homeowners started to fall behind on their payments, leading to a massive number of foreclosure filings. However, mortgage lenders and their attorneys frequently filed shoddy or fraudulent papers in foreclosure proceedings.

Consequently, judicial sentiment then tilted in favor of the homeowner. A common defense involved whether the mortgagee had "standing," and courts began to require lenders to demonstrate this, once a homeowner pleaded it as an affirmative defense.

One of the big issues concerning standing became "show me the note." A lender must demonstrate that it had actual possession of the promissory note at the time it commenced the foreclosure action. Issues such as this are routinely litigated in state court. However, every now and then, these issues spill over into bankruptcy court.


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One such instance recently landed in the lap of Judge Alan S. Trust, sitting in the Central Islip Bankruptcy Court. A homeowner, who had been exceptionally zealous in defending a foreclosure suit since 2009 sought Chapter 7 bankruptcy relief and filed a consumer bankruptcy petition on December 30, 2015, listing, among other things, ownership of a house in Uniondale. By virtue of the automatic bankruptcy stay, any foreclosure litigation was stayed upon the filing of the bankruptcy case.

Several months after filing, the rather aggressive debtor filed an adversary proceeding against the lender, in which he alleged under various theories that the lender is not the holder of the note and mortgage.

As is standard with all adversary proceedings, the court held a status conference a few months after the case was commenced. At the conference, Judge Trust determined that a substantial question existed as to whether the Bankruptcy Court should hear the adversary proceeding or whether it should abstain from doing so.

He noted that the debtor's claims involved issues purely pertaining to state law, which was already the subject of the state court foreclosure proceeding. Accordingly, he issued a *sua sponte* order to show cause as to why the Bankruptcy Court should not abstain from hearing the adversary proceeding case.

On February 2, 2017, Judge Trust issued a written decision in which he abstained from hearing the adversary proceeding. *In re Osuji*, 564 B.R. 180, (Bankr. E.D.N.Y. Case No. 8-15-75534-ast). The court determined that permissive abstention from the adversary proceeding was warranted for the efficient administration of the estate, as the trustee had determined not to pursue any interest in the house, state law issues predominate over bankruptcy related issues, and because there is pending state court proceeding related to the property. As Judge Trust put it, "Thus, the issues of who has what rights in the property will be determined in state court, not this Court."

A month later, on March 15, 2017, Deutsche Bank filed a standard motion for relief, in which it sought the court's permission to lift the stay so that it could continue the foreclosure proceeding in state court. In support of the motion, the bank included an affirmation of its attorney stating that the bank is the holder of the note which is endorsed in blank and the assignee of the mortgage.

One week before the hearing date, the debtor, who was represented by counsel, filed an extensive opposition to the motion that was more than 500 pages long. The bank's attorneys rushed to file an emergency motion in which it sought an extension of time to respond to the time of legal opposition it had just received.

Instead of granting the bank any additional time, Judge Trust held the hearing on the motion for relief as originally scheduled. As the bank would soon learn, it need not have brought the emergency motion. The bank's attorney also brought the original note to the hearing.

Judge Trust concluded that the bank had successfully demonstrated, for purposes of the motion, that it was the holder of the note endorsed in blank and that it had standing to seek relief from the automatic stay. He thus granted relief from the stay and issued his second written decision in the case discussing the basis for demonstrating whether cause exists to lift the stay. *In re Osuji,* (Bankr. E.D.N.Y., Case No. 8-15-75534-ast, May 10, 2017).

It appears that Judge Trust kept these matters on a very tight leash. Often, the mere filing of substantial opposition papers, at least in state court, results in an extended period before the court makes a decision, essentially buying the homeowner many additional months in the house. Indeed, this is often part of a strategy to extend the time a homeowner has in the house.

However, in keeping the time between submission of motion papers, holding hearings and rendering decisions to an absolute minimum, Judge Trust was likely sending a message that debtors in foreclosure who file substantial motion papers or bring adversary proceedings in Bankruptcy Court, essentially to prolong proceedings with ineffective legal arguments, will not work in his court.

More importantly, most foreclosure defense issues belong in state court and not Bankruptcy Court. Homeowners who choose to litigate these issues in Bankruptcy Court may find themselves wasting their time.

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