THE SUFFOLK LAWYER
THE OFFICIAL PUBLICATION OF THE SUFFOLK COUNTY BAR ASSOCIATION
DEDICATED TO LEGAL EXCELLENCE SINCE 1908
website: www.scba.org
Vol. 29 No 8
MAY 2014

LAND TITLE LAW

Tax Titles and the Automatic Stay

By Lance R. Pomerantz

Few topics in the practice of land title law offer as many potential pitfalls as titles derived from tax sales. One of those few topics is bankruptcy. When the two intersect, things get interesting.

The Automatic Stay

Pursuant to §362(a)(4) of the Bankruptcy Code, the filing of a bankruptcy petition operates as a stay of any act to create, perfect, or enforce any lien against property of the bankruptcy estate. It arises *ex parte*, and binds all such creditors whether or not they are aware of the filing (hence the term "automatic stay"). Among those creditors are local authorities trying to collect delinquent pre-petition real estate taxes. New York State Real Property Tax Law §1140(1) recognizes that the filing of the petition "shall stay a proceeding to enforce a delinquent tax lien, to the extent required by the bankruptcy code." Creditors subject to the automatic stay are permitted to seek relief from the bankruptcy court.

Although the concept seems straightforward, creditors can unintentionally violate the stay due to ignorance of the filing, bureaucratic error within the creditor's organization or a misunderstanding of the scope and duration of the stay.[1] These violations pose risks for other creditors as well as the bankruptcy estate. Most violations arising for these reasons are caught early on and potentially harmful effects are ameliorated. Because real estate taxes enjoy "super-priority" status under state law, tax collection procedures taken in violation of the automatic stay can pose special challenges to the other creditors who hold mortgages on property of the estate.

A tale of two court systems

Two recent New York cases arise out of similar facts. Both involved secured lenders whose priority was dislodged by tax collection procedures taken in violation of the stay. In each case, the violation was discovered after the debtor had been discharged. One creditor was allowed to seek a remedy for the violation, while the other was denied that opportunity. The big difference? One sought relief in the bankruptcy court, relying on bankruptcy procedures, while the other sought relief in the New York Supreme Court under state law.

Give us the bad news first

In the Matter of the Foreclosure of Tax Liens by City of Troy, 2014 NY Slip Op 01657 (3rd Dept., March 13, 2014) concerned a debtor who filed for Chapter 7 in Arizona in 2008. In March 2009, the bank obtained relief from the automatic stay and continued to prosecute its foreclosure action. Very soon thereafter, on April 15, 2009, the City of Troy commenced an *in rem* proceeding for failure to pay property taxes in 2005 and 2006. The city neither sought nor obtained relief from the automatic stay. Five days later, the debtor was discharged from bankruptcy.[2] In June 2009, the bank obtained a judgment of foreclosure and sale, but for reasons that remain unclear, never completed the foreclosure sale.

A copy of the petition and notice from the *in rem* proceeding, along with other statutorily required notices, were sent to the bank on June 1, July 1 and August 1, 2009. The property was conveyed by tax deed to the City of Troy in October 2009 and then quitclaimed to a third party in June 2012.

In December 2012, the bank went into County Court and moved to be relieved of the judgment entered in the *in rem* foreclosure. The bank asserted that when the city commenced the tax foreclosure proceeding on April 15, 2009, the automatic stay was still in effect with respect to that proceeding and County Court lacked subject matter jurisdiction to issue the subsequent judgment. County Court denied the motion.

The Appellate Division affirmed. It applied the statutory presumption of regularity found in Real Property Tax Law §1137. "Where an entity with a purported interest in real property that was subject to a tax sale neglects to challenge the sale in any fashion for two years, a conclusive presumption arises regarding the procedural regularity of all proceedings regarding the sale [citations omitted]." It relied upon *George F. Weaver Sons Co. v Burgess*, 7 NY2d 172 (1959) and *In re Askew*, 312 BR 274 (Bankr. D.N.J. 2004) in holding that the delay in seeking relief trumped the violation of the automatic stay. Under these circumstances, the violation was not a jurisdictional defect "of the nature mandating relief under CPLR 5015 a)(4)."

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It's warmer down south

Just four months before *City of Troy* came down, the U.S. Bankruptcy Court for the Southern District of New York handed down its decision on a motion to reopen proceedings in *In re Killmer,* No. 07-36011 (Bankr. S.D.N.Y. Nov. 15, 2013).

Killmer involved a debtor who was discharged in February 2008, although the case was not closed until 2011. In November 2008, the Dutchess County Commissioner of Finance commenced an *in rem* tax foreclosure proceeding against the mortgaged property, without obtaining relief from the automatic stay. In 2010, the tax foreclosure judgment was entered and title was conveyed to the County, who then sold it at auction to Conway, the successful bidder.[3]

In 2013 the lender, Beneficial Homeowner Service Corporation, commenced foreclosure proceedings on its mortgage. Conway moved to dismiss and Beneficial raised the automatic stay in opposition to the motion. As in *City of Troy,* Conway argued that the RPTL §1137 presumption prevented Beneficial from challenging the validity of the tax sale. The court agreed. Unlike the bank in *City of Troy,* however, Beneficial did not go to the Appellate Division — it headed back to Bankruptcy Court and moved to reopen the case.

The court found the tax foreclosure occurred in violation of the stay, rendering the sale and transfer void *ab initio.*[4] Conway had argued that the discharge automatically terminated the stay pursuant to Bankruptcy Code §362(c)(2). Because the tax proceeding was *in rem,* the Court determined that §362(c)(1) controlled ("the stay of an act against property of the estate…continues until such property is no longer property of the estate"). Under §554(c), the property remained "property of the estate" until the case was closed in 2011. Before you could say "*Rooker-Feldman,*" the court granted the motion to reopen.[5]

Note: Lance R. Pomerantz is a sole practitioner who provides expert testimony, consultation and research in land title disputes. He is also the publisher of the widely read land title law newsletter "Constructive Notice." For more information, please visit www.LandTitleLaw.com.

1. Willful violations of the stay are outside the scope of this article.
2. The bankruptcy case was not closed until February 20, 2013. The Appellate Division opinion does not mention this fact. It was obtained from the author's independent examination of the bankruptcy case on PACER.
3. Some of the facts in this summary are taken from the state court Decision and Order in *Beneficial Homeowner Service Corporation v. Joanne Killmer, et al.,* No. 2013/2302 (Sup. Ct., Dutchess County, Sept. 9, 2013). A copy of this order was before the bankruptcy court as an exhibit to the motion to reopen and was specifically cited by the bankruptcy court in its decision.
4. The circuits have split on whether acts in violation of the stay are void or merely voidable. The Second Circuit, however, follows the majority rule that such actions are void and without effect. *In re 48th Street Steakhouse, Inc.,* 835 F.2d 427 (2nd Cir., 1987), *cert. denied* 485 U.S. 1035 (1989).
5. Because bankruptcy courts have original and exclusive jurisdiction of all cases arising under the Bankruptcy Code, a state court cannot annul the automatic stay by validating an action that would otherwise be considered void. In the Second Circuit, any proceedings or actions are void and without legal effect if they occur after the automatic stay takes effect. Hence, the *Rooker-Feldman* doctrine does not bar a collateral attack on the state court proceeding in Federal court.