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Bankruptcy Hijacking 101: *In Rem* Relief Available Regardless of Debtor and/or Borrower Participation in Hijacking Scheme

By Jeff Tchakarov, Esq., Zieve, Brodnax & Steele, LLP

Around 2012, a new and particularly worrisome trend in bankruptcy fraud emerged, called “hijacking.” Bankruptcy hijacking is a scheme in which an interest in a distressed property is transferred from a borrower to a debtor in bankruptcy in order to take advantage of the automatic stay and stop the foreclosure of the borrower’s property. The debtor is typically unaware of the hijacking and sometimes even the borrower knows nothing of the scheme, which is usually perpetrated by an unscrupulous individual promising to help the borrower avoid foreclosure. Needless to say, bankruptcy hijacking causes plenty of headache for all parties involved in the bankruptcy and foreclosure process. This has prompted the bankruptcy courts to approach this issue in a more decisive fashion by granting *in rem* relief from the automatic stay, which continues to be effective notwithstanding future bankruptcy cases involving the same property.

In the recent case of *In re Vazquez*, 580 B.R. 526 (Bankr. C.D. Cal. 2017), the Court examined its jurisdiction and grounds to grant *in rem* relief in hijacked bankruptcy cases. In *Vazquez*, the borrowers fell behind on their mortgage payments and retained the services of an agent, who was supposed to assist them with their loan modification application. Instead, in order to keep the foreclosing lender at bay, the agent purportedly forged an unauthorized and back-dated grant deed transferring a 5% ownership interest in the borrowers’ property to an unrelated third-party debtor, who had recently filed for Chapter 13 relief. Both the borrowers and the debtor claimed to have no knowledge or involvement in the fraudulent the scheme. When the lender moved for *in rem* relief from the automatic stay, one of the borrowers filed an opposition.

As a preliminary matter, the borrower argued that since the debtor had disclaimed any interest in the property, the Bankruptcy Court lacked *in rem* jurisdiction over said property and therefore could not grant *in rem* relief – *i.e.*, relief that follows the property into any future bankruptcy case. The Court rejected this argument on four grounds. First, the Court

explained that the automatic stay is deemed to be an order of the Court and there is no authority preventing the Court from determining the scope of its own orders, even without having *in rem* jurisdiction over property. *In re Dyer*, 322 F.3d 1178, 1191 (9th Cir. 2003) (“the automatic stay qualifies as [a] court order”). Second, it is well-established that once the automatic stay has been implicated, Bankruptcy Courts have the jurisdiction to grant relief from that stay, even if the subject property is no longer part of the bankruptcy estate, such as after dismissal and closing of a case. *In re Aheong*, 276 B.R. 233, 242 (9th Cir. BAP 2002) (upholding jurisdiction to annul automatic stay after dismissal of bankruptcy case). Third, the

Court found that it did have *in rem* jurisdiction over the subject property. The Court explained that real property is traditionally described as a “bundle of rights” – not just dirt and improvements – and at least some of those rights were transferred to the bankruptcy estate by virtue of the grant deed prepared by the borrowers’ agent. Specifically, the bundle of rights included the right of an owner of property to invoke the automatic stay to protect that property. Because at least that much of a property interest was transferred into the Chapter 13 estate, regardless of the

debtor’s subsequent refusal to accept any transfer of the property, the Court concluded that it could exercise *in rem* jurisdiction. Unfortunately, the Court did not address the issue of whether the purported forgery of the grant deed may have affected the validity of any transfer of property interest into the bankruptcy estate. Fourth, and finally, the Court noted that having invoked the Court’s jurisdiction to obtain the benefits of the automatic stay, the borrower was judicially estopped from subsequently asserting that the Court lacked jurisdiction to issue further orders granting relief from that same stay. *Hamilton v. State Farm Fire & Cas. Co.*, 270 F.3d 778, 782 (9th Cir. 2001) (“Judicial estoppel is an equitable doctrine that precludes a party from gaining an advantage by asserting one position, and then later seeking an advantage by taking a clearly inconsistent position”).

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Bankruptcy Hijacking 101...Continued

The Court next analyzed its grounds for granting *in rem* relief under § 362(d)(4) of the Bankruptcy Code, which requires a finding “that the filing of the petition was part of a scheme to delay, hinder, or defraud creditors” by virtue of the property transfer. 11 U.S.C. § 362(d)(4) (emphasis added). Although the Court found that the debtor was ignorant of the grant deed and did not participate in the scheme, the debtor’s innocence was not inconsistent with a finding that the filing of the bankruptcy petition “was” part of a scheme warranting *in rem* relief under § 362(d)(4). The latter, the Court elaborated, encompasses situations in which the filing of the petition has been made part of a scheme. In other words, “was” is descriptive, not temporal, and does not exclude fraudulent schemes that were implemented only post-petition. For this proposition, the Court relied on *In re 4th Street Investors, Inc.*, 474 B.R. 709, 711-12 (Bankr. C.D. Cal. 2012), which advanced a similar statutory interpretation in the wake of the bankruptcy hijacking trend.

The Court then addressed the issue of how the borrowers’ alleged lack of personal involvement in the scheme affected the applicability of § 362(d)(4). The opposition argued that in light of the borrowers’ asserted innocence, it was unfair for the Court to grant *in rem* relief preventing the borrowers from obtaining automatic stay protection for the property by filing their own bankruptcy petition in the future. The Court first noted the flip side of the issue, namely that it would be unfair to make the foreclosing lender bear the burden of the harm caused by the borrowers’ agent who was sufficiently cloaked with the apparent authority to act on the borrowers’ behalf. More importantly, the Court clarified that its *in rem* order would not prevent the borrowers from availing themselves of the protections of the automatic stay with regard to the property. Instead, the *in rem* relief would only preclude the stay from arising automatically in any future bankruptcy cases involving the property, which are filed within two years of entry of the *in rem* order. In other words, the borrowers could subsequently file their own bankruptcy case and move for relief from the Court’s *in rem* order “based upon changed circumstances or for good cause shown, after notice and a hearing,” as provided in § 362(d)(4) itself. Finally, the Court noted that the *in rem* order would contain a provision staying foreclosure of the property for 28 days to provide the borrowers ample time to seek a stay from an appellate court or other relief. In light of the fairness of the borrowers’ alternatives and the creditor’s entitlement to

relief under § 362(d)(4), the Court concluded that granting *in rem* relief despite the borrowers’ innocence was appropriate.

Lastly, the Court ruled that in addition to § 362(d)(4), *in rem* relief could also be granted either “for cause” under § 362(d)(1) alone, or in conjunction with other authority, *e.g.*, § 105(a), which bestows upon the Court its equitable powers and authorizes it to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the [Bankruptcy Code].” In an interesting footnote, the Court disagreed with decisions that appear to narrow § 105(a) almost, if not entirely, out of existence, if by doing so they would deprive the Bankruptcy Courts of the power to prevent hijacking abuse.

In re Vazquez is an excellent example of the courts’ tougher approach toward bankruptcy abuse, regardless of debtors and/or borrowers’ knowing participation in the hijacking scheme.



Jeff Tchakarov is an associate litigation attorney with Zieve, Brodnax & Steele, LLP in Irvine, California. Prior to joining the firm, Mr. Tchakarov served as a judicial law clerk for several bankruptcy judges in the Central District of California. His practice emphasizes matters involving defaulted loans, foreclosures, lender liability, and bankruptcy. He can be reached at jtchakarov@zbslaw.com.

