CONSUMER BANKRUPTCY

Trustee Short Sales May Be Heading to Supreme Court

By Craig D. Robins

One of the most controversial issues our bankruptcy bar is talking about is whether a Chapter 7 trustee may force a short sale.

Here's the scenario. A typical homeowner seeks Chapter 7 relief while in foreclosure with a home that is very much underwater. In years past, the debtor would sail through the case, receive a discharge, and be able to continue residing in the home until the lender conducts a sale or the debtor is able to obtain a modification. The trustee would not have thought twice about doing anything with the house.

Recently, however, some creative Chapter 7 trustees in other jurisdictions have effectively turned the Bankruptcy Court into an expedited foreclosure court. To do so, they approach the mortgagee and offer to get it title to the property much faster than they could have obtained it if they plodded ahead with the state court foreclosure proceeding. In return, the trustee merely asks for a "carve-out" — a sum of money, perhaps $15,000 to $25,000 — that the trustee can not only use to pay a distribution to unsecured creditors, but also pay himself a commission and legal fees.

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Of course, the problem here is that this essentially requires kicking the debtor out of his house without receiving anything, a debtor who thought his home would be totally safe because there is no equity in it. Over the past year or two, some aggressive trustees in the Eastern District of New York have sought to pursue this maneuver causing a panic among consumer bankruptcy practitioners.

However, it seems that most of our judges are unwilling to permit trustees to do so, unless the trustee can sell the property and pay the debtor the full value of the homestead exemption.

This is an issue that has been addressed to varying degrees at several of our CLE's, and most recently at seminar on Sept. 6, 2018 featuring national bankruptcy celebrity, Bill Rochelle, Editor at Large for the American Bankruptcy Institute. Also speaking were Central Islip Bankruptcy Judge Alan S. Trust, and practitioners Adam P. Wofse and Matthew V. Spero.

Mr. Rochelle noted that some jurisdictions permit trustees to scheme with the mortgagee to sell a home out from underneath a debtor without paying the homestead exemption in full, even when there is little or no equity in the property above the secured debt. Yet, other jurisdictions are steadfast against this practice.

Mr. Rochelle mentioned that there may soon be a split of authority among circuits which could propel the issue to the Supreme Court. In *Brown v. Ellmannn (In re Brown*), 851 F.3d 619 (6th Cir. 2017), the Sixth Circuit, in permitting the trustee to conduct the short sale, determined that the debtor was not entitled to claim any homestead exemption under Michigan law because there was no equity in the property.

Meanwhile, in the Tenth Circuit, in the case of *Jubber v. Bird* (*In re Bird*), 577 B.R. 365 (B.A.P. 10th Cir. 2017), the court refused to permit the trustee to conduct a short sale as doing so would only generate fees at the debtor's expense. In that case, the debtor would have received nothing for his homestead exemption, while the trustee and broker together would have gotten more than $60,000, while unsecured creditors would have only recovered $10,000.

Thus, Mr. Rochelle pointed out, unless the Supreme Court takes up the issue, individuals in the Sixth Circuit, as well as perhaps other jurisdictions, risk losing their homes to aggressive trustees pursuing such short sales. In our jurisdiction, however, we have no case law, but it appears that our judges will require debtors to receive the net sales proceeds in short sales up to the value of their homestead exemptions, effectively preventing trustees from entering such short sales. It also appears that some of our judges at least do not feel it is appropriate for the Bankruptcy Court to become a fast-track foreclosure court, when that is not what bankruptcy is about.

Note: Craig D. Robins, a regular columnist, is a Long Island bankruptcy lawyer who has represented thousands of consumer and business clients during the past 33 years. He has offices in Melville, Coram, and Valley Stream. He can be reached at CraigR@CraigRobinsLaw.com or by calling (516) 496-0800. Please visit his Bankruptcy Website: www.BankruptcyCanHelp.com and his Bankruptcy Blog: www.LongIslandBankruptcyBlog.com.