CT Bankruptcy Beat
Legal Developments in Restructuring and Creditors' Rights

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New York Bankruptcy Courts Hold That a Debtor's Failure to Make Postpetition Loan Payments is a Basis for Granting Relief from the Automatic Stay

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There are basically two alternative grounds for a secured lender to achieve a lifting of the automatic stay imposed by the bankruptcy filing of its borrower. One is to establish that the debtor has no equity in the lender's collateral and that the collateral is not necessary for an effective reorganization. 11 U.S.C. §362(d)(2). "Equity in this context refers to the "difference between the property value and the total amount of liens against it." *In re New Era Company,* 125 B.R. 725, 728 (S.D.N.Y. 1991). In Chapter 7 bankruptcy cases, the requirement that collateral must not be necessary to an effective reorganization is automatically established because Chapter 7 is concerned with liquidation, not reorganization. *See In re Speer,* 2015 WL 5601469, at *3 (Bankr. D. Conn. Aug. 13, 2015); *In re Diplomat Electronics Corp.,* 82 B.R. 688, 693 (Bankr. S.D.N.Y. 1988).

The other basis upon which relief from the automatic stay will be granted is formulated generally as "cause," which includes a "lack of adequate protection of an interest in property," such as a mortgage or security interest. The statutory standard of "cause" carries with it a list of 12 factors courts consider in determining whether it has been established. These factors have come to be known as the "Sonnax factors," named after a decision rendered by the Second Circuit Court of Appeals in *In re Sonnax Industries, Inc.,* 907 F.2d 1280, 1286 (2d Cir. 1990).

A lack of adequate protection, which is a subset of "cause," generally requires proof of a "decline in the value of the collateral during the automatic stay." *In the Matter of East-West Associates,* 106 B.R. 767, 773. According to *Sonnax*, a

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creditor seeking to lift the automatic stay for cause must make "initial showing of cause," before the burden of proof shifts to the debtor to disprove "cause." *Sonnax,* 907 F.2d at 1285.

To prove or make an initial showing that a creditor's collateral is declining in value, resulting in a lack of adequate protection, can be difficult because in some instances, there may not be a precise measure of a decline or it may require appraisal testimony. However, this difficulty may be alleviated if the debtor has failed to make postpetition mortgage or other loan payments to the creditor.

Indeed, the recent decision in *In re Sterling,* 2018 WL 313085 (Bankr. S.D.N.Y. Jan. 5, 2018) confirmed that a lack of adequate protection can be shown merely by showing that the debtor has failed to make postpetition mortgage payments. *Id.* at *5. To the same effect is the holding in *In re Watkins,* 2018 WL 3575336, at *2 (Bankr. S.D.N.Y. Jan. 9, 2018), where the Bankruptcy Court "infer[red]" that the value of a vehicle declined or threatened to decline simply by the debtor's use of the vehicle and failure to make postpetition loan payments. *Id.* at *2. These cases and the cases they follow can therefore be a significant benefit to a secured creditor that might otherwise face a difficult burden to show its collateral is declining in value.