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Does The Automatic Stay Apply To Stay Acts Against An Individual Debtor's Wholly-Owned Company?

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A vexing issue for some creditors arises when an individual who is typically a guarantor or co-debtor of his wholly-owned company's debt files bankruptcy under chapter 7, 11 or 13 and then takes the position that the automatic stay thereby imposed applies to stay actions against his or her wholly-owned corporation or limited liability company. Whether it involves a pending foreclosure action against the individual debtor's entity or simply an action to collect a debt, confronting a claim that one is violating the automatic stay naturally gives pause in proceeding with further activity. Whether such pause is justified is another matter.

Courts generally have been hostile to the position that the automatic stay imposed by an individual bankruptcy should extend to the individual's wholly-owned corporation or LLC, but it is not without some support. For example, in *Queenie, Ltd. v. Nygard*, 321 F.3d 283 (2d Cir. 2003), the Second Circuit Court of Appeals applied the automatic stay imposed by an individual's chapter 11 filing to a non-debtor corporation wholly owned by the individual, Gardner, on the basis that "adjudication of a claim against the corporation will have an immediate adverse economic impact on Gardner." *Id.* at 288. The action at issue in *Queenie* was the appeal by Gardner and his wholly-owned corporation, Queenie, Ltd., of an adverse judgment against them.

Courts have reached the opposite conclusion, however, when the individual debtor files bankruptcy under chapter 13 or 7 of the Bankruptcy Code. In *In re McCormick*, 381 B.R. 594 (Bankr. S.D.N.Y. 2008), for example, the individual chapter 13 debtor sought to extend the automatic stay to his wholly-owned LLC and employer, Donald J. McCormick Construction, LLC, to stay collection actions against the LLC on the basis that it would negatively impact his ability to

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reorganize if the relief were not granted. *Id.* at 597-98. The Court expressly recognized the Second Circuit's decision in *Queenie*, but refused to extend the stay to the debtor's LLC because no satisfactory explanation was given as to why the LLC could not commence its own bankruptcy proceeding and invoke its own stay. *Id.* at 602.

The Court also distinguished *Queenie* by noting that the individual debtor there filed a chapter 11 case, not a chapter 13, and was troubled by an extension of the stay because the LLC could neither be a debtor under chapter 13, nor a co-debtor under chapter 13 to which the co-debtor stay under section 1301(a) of the Bankruptcy Code could apply. *Id.* The LLC could not be a debtor under chapter 13 because relief under chapter 13 is only available to "individuals," *id.* at 597-98, and also could not take advantage of the co-debtor stay because it only applies to co-debtors that are both "individuals" and are liable with the debtor on a "consumer debt." *Id.* at 598. An LLC is obviously not an individual and the debts involved were business, not consumer debts.

In *In re Sheu*, 2009 WL 1794473 (Bankr. E.D.N.Y. June 16, 2009), the individual chapter 13 debtor claimed that the automatic stay was violated by continuing with a foreclosure sale of property one day after his chapter 13 filing where title to the property was in the name of his wholly-owned corporation and the individual debtor resided at the property. *Id.* at *1. The relief requested was to rescind the sale. The Court matter-of-factly denied the request, citing the inequity in applying the stay to the non-debtor corporation when the individual formed it as a separate entity to protect his assets from corporate creditors and corporate assets from his personal creditors. *Id.* at *2. The property of the debtor that was protected by the stay, held the Court, was only the individual debtor's rights of ownership of the corporation and not the corporation's underlying assets. *Id.*

In *In the Matter of Penn*, 2010 WL 9445533 (Bankr. N.D. Ga. Apr. 2, 2010), the holder of a mortgage against property owned by the individual chapter 13 debtor's LLC, and where the debtor claimed to reside, filed a motion to validate a foreclosure sale of the property that was conducted after the chapter 13 petition was filed. *Id.* at *1. Like the Court in *Sheu*, the Court in *Penn* held that the automatic stay did not apply to the foreclosure sale because the individual's ownership interest in the LLC gave him no direct ownership interest in its assets. *Id.* at *2. The Court also refused to allow the individual to escape the consequences of placing ownership of property in the name of the LLC when it now suited his individual interests. *Id.*

Similar results have been met in the chapter 7 context. In *Manson v. Friedberg*, 2013 WL 2896971 (S.D.N.Y. June 13, 2013), the Chapter 7 trustee of Richard Friedberg contested a Magistrate's Report that confirmed a default judgment entered against Friedberg's wholly-owned LLC, Oldstone Ventures, LLC, while his chapter 7 case was pending, on the theory that because Friedberg owned Oldstone, the automatic stay should apply to preclude entry of a judgment against Oldstone. *Id.* at *2. This argument was flatly rejected on the basis that ownership of an LLC is merely personal property of the owner and does not confer any ownership interest in

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the LLC's assets. *Id.* at *3.

Under the prevailing case law in the Second Circuit, an individual debtor under chapter 11 may be protected by the automatic stay from actions against his or her wholly-owned corporation or LLC, but such protection probably does not apply if the individual files a chapter 13 or chapter 7 bankruptcy proceeding.

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