12-4131-CV

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

MARY VERONICA SANTIAGO-MONTEVERDE,
Debtor-Appellant,

v.

JOHN S. PEREIRA
Respondent-Appellee.

On Appeal from the United States District Court
for the Southern District of New York

BRIEF OF *AMICUS CURIAE* MFY LEGAL SERVICES, INC. IN SUPPORT OF PETITIONER-APPELLANT AND ARGUING FOR REVERSAL

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CORPORATE DISCLOSURE STATEMENT OF
MFY LEGAL SERVICES, INC.

MFY Legal Services, Inc., an organizational amicus curiae, is a non-profit, non-stock corporation. It has no parent corporations, no publicly held corporations have ownership interests in it, and it has not issued shares.

Dated: January 30, 2013
New York, New York

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES

TREATISES

MISCELLANEOUS

STATEMENT OF AMICUS CURIAE MFY LEGAL SERVICES, INC.

MFY Legal Services, Inc. (MFY) envisions a society in which no one is denied justice because he or she cannot afford an attorney. To make this vision a reality, for 50 years MFY has provided free legal assistance to residents of New York City on a wide range of civil legal issues, prioritizing services to vulnerable and under-served populations, while simultaneously working to end the root causes of inequities through impact litigation, law reform and policy advocacy. We provide advice and representation to more than 8,000 New Yorkers each year.

MFY established the Low-Income Bankruptcy Project (LIBP) in September 2012 to serve New York City residents who are in need of bankruptcy protection but who are unable to afford an attorney. LIBP's clients live on fixed incomes or work low-wage jobs; many also depend on rent-regulated apartments, or housing subsidized by Section 8 or the public housing system. In the few short months that LIBP has operated, numerous individuals desperately seeking bankruptcy protection have contacted MFY seeking a fresh start, only to be advised that a bankruptcy filing could put their rent-stabilized apartment at risk because of the issue presented by the case now on appeal. The decisions below would allow a bankruptcy trustee to treat a rent-stabilized lease as an asset, the value of which can be distributed to creditors. The debtor, having received her discharge in

bankruptcy, will become homeless, subverting the fresh start provided by the Bankruptcy Code.

Debtors in rent-stabilized apartments – unlike similarly situated debtors residing in unregulated apartments, public housing, limited-equity co-ops, or receiving Section 8 benefits – currently face tremendous uncertainty in the bankruptcy system. If a decision authorizing the termination of rent-stabilized leases in bankruptcy is allowed to stand, the number of people who will be disenfranchised from availing themselves of bankruptcy protection is staggering. In New York City, there are about one million rent-stabilized housing units and about 38,000 rent-controlled units, collectively housing at least two million individuals.

In order to avoid the risk posed by the current practice of some bankruptcy trustees assuming and assigning debtors' rent-stabilized leases, these debtors will continue to endure and fear harassing phone calls, creditor lawsuits, and wage garnishment. MFY believes this practice to be unjust and unlawful, as it undermines the very purpose of the Bankruptcy Code – to provide a fresh start for the honest debtor. No party's counsel authored the brief in whole or in part and no party or party's counsel or person contributed money that was intended to fund preparing or submitting the brief.

SUMMARY OF ARGUMENT

The practice of bankruptcy trustees seeking to assume and assign rent-stabilized leases poses a grave threat to the stability of the rent stabilization system and to the integrity of the bankruptcy process. This illegal and unjust practice effectively bars access to bankruptcy protection for every New Yorker who depends on a rent-stabilized lease. The sole reason for a trustee to assume a rent-stabilized lease in a Chapter 7 bankruptcy proceeding is to assign the lease to the landlord, generating value for the estate, while forcing the debtor from his or her home. Debtors who depend on rent stabilization to keep their housing costs affordable cannot avail themselves of the protection offered in bankruptcy because they simply cannot afford to put their rent-stabilized leases at risk. The threat of losing a rent-stabilized apartment dissuades filings by debtors desperately in need of bankruptcy protection. For debtors in rent-stabilized apartments, the fresh start offered by bankruptcy proves a false promise. As a matter of public policy, this practice must be stopped.

Section 365(a) of the Bankruptcy Code provides that "the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor." 11 U.S.C. § 365(a). Recognizing that the practical effect of assuming a rent-stabilized lease will be to terminate a debtor's tenancy and destroy the debtor's fresh start, leaving the debtor worse off than before she sought

bankruptcy protection, this Court should find that a rent-stabilized lease must be treated as exempt property under New York State law, removing it from the reach of the bankruptcy trustee. Alternatively, the Court should find that § 365 does not permit assumption and assignment of a rent-regulated lease. By doing so, this Court will restore the promise of a fresh start to the two million New Yorkers residing in rent-stabilized apartments.

BRIEF STATEMENT OF FACTS

Debtor-appellant Mary Veronica Santiago-Monteverde has resided in a rent-stabilized apartment in New York City's East Village since the 1960s. After the death of her husband, Ms. Santiago filed a Chapter 7 bankruptcy petition. The Trustee in her case – the Appellee before this Court – sought to assume and assign her lease to her landlord, a procedure which would result in her eviction from an apartment where she has resided for more than 40 years, where she has never been late on her rent, and where she receives an important Senior Citizen Rent Increase Exemption (SCRIE) benefit.[1] The debtor then amended her bankruptcy petition, stating that the value of her rent-stabilized lease is exempt from the bankruptcy estate as a "local public assistance benefit" under 11 U.S.C. § 522(b) and § 282(2)

[1] The SCRIE benefit is available to individuals who are at least 62 years old, rent an apartment that is rent-regulated, have a total annual household income of $29,000 or less, and pay more than one-third of their household's total monthly income in rent. 9 N.Y.C.R.R. § 2202.20.

[2] Doing so may also remove the apartment from rent regulation entirely, if, for example, the resulting vacancy increase is sufficient to bring the legal rent beyond the threshold for luxury deregulation. *See* 9 N.Y.C.R.R. § 2520.6.

of the New York Debtor and Creditor Law. The trustee moved to strike the exemption. The bankruptcy court granted the motion to strike (466 B.R. 621 (Bankr. S.D.N.Y. 2012)) (Record at 91), and the debtor appealed. The district court upheld the bankruptcy court in an unreported decision. 2012 WL 3966335 (S.D.N.Y. 2012) (Record at 100). The debtor appealed, bringing the case before this Court.

RENT-STABILIZATION AND BANKRUPTCY: AN OVERVIEW

New York City has long been one of the most expensive residential real estate markets in the country, with high demand and low vacancy pushing rents into the stratosphere. In numerous laws and regulations enacted since the 1970s, the State Legislature and the City Council have found that "a serious public emergency continues to exist in the housing of a considerable number of persons within the state [or city] of New York." *See, e.g.*, NYC Admin. Code §§ 26-501-502; N.Y. EMERGENCY TENANT PROTECTION ACT § 2 (1974) (renewed 2011). New York City's rent stabilization laws and regulations form a comprehensive system designed to preserve affordable housing for the City's low-income, working poor, and middle class residents. *See* FURMAN CENTER FOR REAL ESTATE & URBAN POLICY, FACT BRIEF: RENT STABILIZATION IN NEW YORK CITY 3 (2012) [hereinafter FURMAN CENTER REPORT], *available at* http://furmancenter.org/files/publications/HVS_Rent_Stabilization_fact_sheet_FIN

AL.pdf (stating that "stabilized units are home to lower income households than market-rate units [are]"). Recognizing that, unlike virtually every other area of the country, New York is a city of lifelong renters, the State Legislature and the City Council have enacted a comprehensive regime of regulations designed to protect "over two million New Yorkers who call their apartments 'home'." Statement of Sen. Skelos, Sen. Bill 5856, bill jacket at 20, *et seq* (reporting that 62% of rent-stabilized households make $50,000 a year or less). These laws provide protection from eviction except for cause and the perpetual right to a renewal lease for rent stabilized tenants. 9 N.Y.C.R.R. § 2524.1; *see also Caine v. Carreker*, 116 Misc.2d 419, 457 N.Y.S.2d 682 (App. Term 1st Dep't 1982) ("[T]he right to a renewal lease is one of the cornerstones of the rent stabilization system"). These provisions, coupled with the rent stabilization laws' limitations on rent increases, give tenants reassurance that they will be able to meet their housing costs in the future. Rent stabilization benefits individual tenants and the city as a whole by "providing an adequate supply of affordable housing." *Drucker v. Mauro*, 30 A.D.3d 37, 40, 814 N.Y.S.2d 43, 45 (App. Div. 1st Dep't 2006).

Rent stabilization covers 986,840 units of housing in New York City: 31% of all units in the city and 45.4% of all rental units. FURMAN CENTER REPORT 1. Units are subject to rent stabilization in various ways: some buildings by virtue of their age and size, others in exchange for city property tax benefits. *Id.* The

median contract rent in rent-stabilized units was $1,050 as of 2011; for unregulated units the median rent was $1,369. NEW YORK CITY DEPARTMENT OF HOUSING PRESERVATION AND DEVELOPMENT, 2011 HOUSING VACANCY SURVEY 6 [hereinafter HPD REPORT]. Even so, residents of rent-stabilized units paid, on average, a larger percentage of their income in rent than residents of non-regulated units: 32.1% compared to 30.5%. *Id.* at 7.

Tenants in rent-stabilized apartments maintain longer-term tenancies compared to the entire New York City population. In New York City overall, just 7.1% of all market-rate renters moved in to their current apartments more than 20 years ago. However, 23.1% of the city's rent-stabilized tenants have resided in the same apartment for two decades or more. FURMAN CENTER REPORT 4. The divide is even more striking in Manhattan below 96th Street: in that part of the city, 35.2% of rent-stabilized tenants moved in before 1991, as compared to just 2.7% of market-rate tenants. *Id*. These figures demonstrate that rent stabilization provides an important measure of residential continuity in an ever-changing city, and that rent-stabilized tenants are less mobile and less able to seek new housing accommodation than those renting at market rates.

Rent regulation benefits the city's most vulnerable residents: the poor, the elderly, and residents of color. Median income for rent-stabilized tenants is $36,600, compared to $52,260 for market rate tenants. *Id*. A total of 17.4% of

rent-stabilized households are headed by an individual over the age of 65 – more than double the rate for non-regulated units – and 56% of non-regulated units are occupied by non-white renters, compared to 63.7% of rent-stabilized units. *Id.* at 4-5.

Losing a rent-stabilized apartment can be catastrophic for a low-income renter, as comparable affordable housing can be unobtainable. *See* HPD REPORT 4 (reporting that, in 2011, vacancy rate for rent-stabilized units was 2.63%; vacancy rate for other regulated housing such as Mitchell-Lama, public housing, and HUD-regulated units was 1.4%; and vacancy rate for units with asking rents below $800 was 1.1%). For many tenants, rent stabilization also brings access to ancillary rent reduction benefits that are not available in unregulated housing units. *See* 9 N.Y.C.R.R. § 2202.20(a), (b) (providing for Senior Citizen Rent Increase Exemption and limiting application of exemption to rent-regulated tenants). The rent stabilization laws contain automatic renewal provisions, protections against eviction, and survivor's rights, ensuring that the benefits of a rent-stabilized tenancy continue to remain available to a tenant and his or her surviving family. *See, e.g.*, 9 N.Y.C.R.R. § 2524.1 (containing restrictions on removal of tenant).

Bankruptcy promises debtors a "fresh start" – "a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy 'a new opportunity in life with a clear field for future effort, unhampered by

the pressure and discouragement of preexisting debt.'" *Grogan v. Garner*, 498 U.S. 279, 286 (1991) (*quoting Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934)). In order to facilitate this fresh start, the Bankruptcy Code and New York State law permit the debtor to retain certain interests in property as exempt from the bankruptcy estate. *See* 11 U.S.C. § 522; *see also Rousey v. Jacoway*, 544 U.S. 320 (2005) ("[T]o help the debtor obtain a fresh start, the Bankruptcy Code permits him to withdraw from the estate certain interests in property, such as his car or home, up to certain values.").

For a debtor living in a rent-stabilized New York City apartment, nothing could be more important to achieving this fresh economic start than remaining in his or her home. In recent years, however, a troubling new practice has emerged among Chapter 7 trustees in New York City: in order to bring assets into the bankruptcy estate, trustees have sought to assume rent-stabilized leases of debtors under Section 365 of the Bankruptcy Code, and then assign the leases back to debtors' landlords, who are then free to evict the lawful tenants and raise rent by issuing a vacancy lease.[2] This practice can be highly lucrative, generating repayment for creditors and generous fees for the trustees, in what would otherwise be no-asset cases. Permitting the eviction of a tenant for reasons not contemplated

[2] Doing so may also remove the apartment from rent regulation entirely, if, for example, the resulting vacancy increase is sufficient to bring the legal rent beyond the threshold for luxury deregulation. *See* 9 N.Y.C.R.R. § 2520.6.

under the rent stabilization laws can also provide a substantial benefit to landlords who would otherwise have no role in the bankruptcy proceeding. Unscrupulous owners of rent-stabilized buildings have shown a penchant for bending the law to evict rent-stabilized tenants, and this practice of trustees, if endorsed, will almost certainly be abused. *See, e.g.*, *Prometheus Realty v. City of New York*, 2009 WL 2440294 (N.Y. Sup. Ct. 2009) (upholding the Tenant Protection Act as "a rational response to what the City Council has determined is the potential for a growing problem of tenant harassment in New York City"), *aff'd*, 80 A. D.3d 206 (App. Div. 1st Dep't 2010). Debtors, meanwhile, are left facing eviction and possible homelessness, rather than benefiting from the fresh start promised by the Bankruptcy Code. For the reasons below, this practice must be stopped.

ARGUMENT

I. PERMITTING ASSUMPTION AND ASSIGNMENT OF A RENT-STABILIZED LEASE IN BANKRUPTCY COMPROMISES THE INTEGRITY OF THE BANKRUPTCY CODE

A. Bankruptcy exemptions seek to protect items of value to debtors necessary to achieve the fresh start promised by bankruptcy.

Bankruptcy exemptions, whether federal or state, exist to protect the debtor's fresh start. *John T. Mather Memorial Hosp. of Port Jefferson, Inc. v. Pearl*, 723 F.2d 193, 195 (2d Cir. 1983) (finding that the purpose of the New York homestead exemption was clearly to provide debtors with the opportunity to make a fresh start). Exemption statutes are interpreted liberally to facilitate the debtor's

fresh start. *See In re Miller*, 167 B.R. 782, 783 (Bankr. S.D.N.Y. 1994). Permitting debtors to retain certain property allows them to begin anew without starting from nothing, lessening the chance that an individual will once again incur unmanageable debt or become dependent on government aid to survive.

Declaring that a debtor has the right to "exempt" property from the estate really means that he or she has a right to "withdraw[] the property from levy and sale under judicial process." *White v. Stump*, 266 U.S. 310, 313 (1924). Because it is never possible under New York State law for a creditor to execute against a rent-stabilized tenant's lease or against the differential between the tenant's actual rent and the market rent for the apartment, a rent-stabilized lease should be treated as exempt property. *See* ALAN N. RESNICK & HENRY J. SOMMER, EDS., COLLIER ON BANKRUPTCY § 522.10[4] (2011) ("[C]courts have properly found property not subject to process under state law to be the equivalent of exempt property when the debtor utilizes the state exemptions."); *Kashi v. Gratsos*, 712 F.Supp. 23 (S.D.N.Y. 1989) (holding that a rent-regulated lease "is not an attachable property interest in the hands of the lessee").

Finding that a rent-stabilized lease cannot be exempted from the bankruptcy estate, as the courts below have done here, utterly undermines the fresh start for low-income and working poor debtors, who will very likely be unable to find comparable housing elsewhere in the city. *See* HPD REPORT at 4-5 (describing

extremely low vacancy rates in affordable New York City apartments). A debtor forced to relocate will, as a consequence, have to uproot his or her family from the community, including children enrolled in a local school, and from local employment and essential medical and social services, further compromising the fresh start. These consequences demonstrate the paramount importance to a rent-stabilized debtor's fresh start of remaining in his or her home.[3]

Bankruptcy courts routinely consider whether a debtor's home is at stake in deciding questions of bankruptcy law and policy, erring in favor of permitting the debtor to remain in her home to facilitate the fresh start. *See In re Yasin*, 179 B.R. 43 (Bankr. S.D.N.Y. 1995) (excusing the debtor's procedural errors "in light of the Debtor's *pro se* status and the fact that his and his family's home of many years was at stake"). This court should follow this guiding principle and hold that a rent-stabilized lease should be treated as exempt property.

[3] Equally as important to a rent-stabilized tenancy, New York has enacted many need-based financial assistance programs connected to rent-regulated apartments, such as the Senior Citizen Rent Increase Exemption (SCRIE). 9 N.Y.C.R.R. § 2202.20. SCRIE unquestionably qualifies under Section 282(2) of New York Debtor and Creditor Law as "a local public assistance benefit" because it provides a monthly differential payment to a landlord for the difference between the amount a tenant is required to pay under the SCRIE program and the actual rent. In addition, these payments (which are paid to the landlord in the form of a property tax abatement credit) will increase to account for the debtor's future rent increases and for additional increases the landlord may seek under the rent stabilization law for economic hardship and major capital improvements. In all relevant respects, the SCRIE program is a need-based "local public assistance program" associated with a debtor's rent stabilized apartment, subsidizing access to affordable housing in New York City. However, debtors who are forced out of rent-stabilized apartments where they receive SCRIE financial assistance cannot bring the SCRIE benefit to their new residence. The benefit is lost to them permanently.

B. Legislative policy and judicial precedent hold that homeowners and renters should receive parallel treatment in bankruptcy.

The bankruptcy and district court opinions below represent a jarring departure from longstanding legislative determinations and judicial findings that homeowners and renters should receive parallel treatment in bankruptcy. For example, in *Matter of DiCamillo*, a New Jersey bankruptcy court interpreted § 365(c) to permit a Chapter 13 debtor to assume his terminated residential lease, reasoning that "in the Chapter 13 context, Congress has provided certain protections to homeowners to cure default and reinstate mortgages notwithstanding applicable nonbankruptcy law. Surely Congress did not intend to protect homeowners while ignoring the plight of home renters." 206 B.R. 64, 70-71 (Bankr. D.N.J. 2006) (internal citations omitted). By a similar rationale, the New York legislature did not intend to provide a generous homestead exemption for owners of real property while leaving rent-stabilized tenants without any way to protect their homes in bankruptcy. N.Y. C.P.L.R. § 5206 (setting homestead exemption at $150,000 for New York City and Nassau, Suffolk, Rockland, Westchester, and Putnam counties). Because rent-stabilized leases are already excluded from enforcement actions by creditors, as explained in Section A above, the legislature did not need to provide an explicit exemption. *See Kashi v. Gratsos*, 712 F. Supp. at 26 (holding that a rent-regulated lease "is not an attachable property interest in the hands of the lessee"); *Supreme Merchandise Co., Inc. v.*

Chemical Bank, 70 N.Y.2d 344, 520 N.Y.S.2d 734 (1987) (holding that "mere assignability of . . . interest does not warrant the conclusion that [a letter of credit] is 'property' for purposes of CPLR 5201(b)" and therefore cannot be attached by a party in unrelated litigation).

In describing the importance of the homestead exemption to debtors, the Second Circuit held that "the homestead exemption reflects a legislative policy, both state and federal, to provide an honest debtor with a fresh start, and was drafted with the understanding that justice is not served by leaving the debtor and his family homeless and on the brink of financial ruin." *CFCU Community Credit Union v. Hayward*, 552 F.3d 253 (2d Cir. 2009) (internal citations and quotation marks omitted) (applying the increased homestead exemption to debts incurred before passage of the increased exemption amount). For so many debtors in New York City, a rented apartment is home – often for decades – and bankruptcy law has long favored protection of such an essential component of the debtor's fresh start.

C. Section 365 of the Bankruptcy Code does not permit the assumption and assignment of a rent-stabilized lease and the subsequent eviction of a rent-stabilized tenant.

The narrow question on appeal is whether the decision to grant the Trustee's application to strike the Debtor's claimed exemption for the value of her New York City rent-stabilized lease was correct. Amicus argues it was not. However, even if

the Court finds that it was, it does not follow that the Trustee is authorized under the Bankruptcy Code to assume a rent-stabilized lease, evict the debtor, and then sell the lease for consideration. Section 365 of the Bankruptcy Code provides that "the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor." 11 U.S.C. § 365(a). In a case under Chapter 7 of the Bankruptcy Code, an unexpired lease of residential property is deemed rejected if the trustee does not assume or reject the lease within 60 days after the case is filed (absent an extension of time). 11 U.S.C. § 365(d)(1). Under § 365(c), the trustee may not assume any unexpired lease if "applicable law" excuses a non-debtor party to the lease from accepting performance from any party other than the debtor absent the non-debtor party's consent. This section ensures that parties' rights in bankruptcy mirror their state-law rights outside of bankruptcy, in accordance with the general principle that non-bankruptcy law controls property rights in bankruptcy. *See BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1993) (finding that the price at which foreclosed property is sold is reasonable so long as the foreclosure sale is conducted in accordance with state law); *Butner v. United States*, 440 U.S. 48 (1979) (finding that determination of property rights in bankruptcy follows state law); *Matter of DiCamillo*, 206 B.R. 64, 67-68 (Bankr. D.N.J. 2006) (finding bankruptcy courts use state law to determine whether a terminated lease is "unexpired" for purposes of bankruptcy). Permitting

the eviction[4] and displacement of a lawful rent-stabilized tenant and his or her family achieves a vastly different result in bankruptcy than is possible under New York State law. This outcome violates the principles laid down by the Supreme Court in *Butner* and *BFP*.

While no court has ruled squarely that a rent-stabilized lease may be assumed and assigned under § 365, earlier opinions suggest that a Chapter 7 trustee cannot assume a rent-stabilized lease in light of § 365(c), as the rent-stabilization laws excuse the landlord from accepting performance from a third party. *See B.N. Realty Assocs. v. Lichtenstein*, 238 B.R. 249, 254 (S.D.N.Y. 1999) (agreeing with the holding of the bankruptcy court that "the Trustee could never assume or assign this [rent-stabilized] lease"). *But see In re Yasin*, 179 B.R. 43 (Bankr. S.D.N.Y. 1995) ("The Second Circuit's decisions in *Diamond I* and *Diamond II* foreclose the claim that rent stabilized leases are not leases (or contracts) within the meaning of federal law, and hence, 11 U.S.C. § 365. Consequently, they can be assumed or rejected.").[5] The court in *Yasin* was concerned with the argument that rent-regulated leases in New York are "statutory tenancies" rather than lease-based

[4] In fact, possibly putting trustees in a position of evicting tenants raises a host of ancillary questions, including whether tenants' rights throughout the eviction process would be preserved.
[5] *In re Toledano*, 299 B.R. 284 (Bankr. S.D.N.Y. 2003), also suggests that a rent-stabilized lease can be assumed and assigned by a bankruptcy trustee, but its holding rests to a significant degree on *In re Yasin*, which Amicus believes to have been wrongly decided in this regard. Furthermore, the debtor in *Toledano* appeared *pro se*, made significant procedural errors, *id.* at 286, 290-91, and did not argue, as Amicus does here, that a rent-stabilized lease should be exempted from the bankruptcy estate.

tenancies; following Second Circuit precedent it held that they are leasehold tenancies. However, the *Yasin* court did not appear to consider the argument raised here: that because wholly applicable non-bankruptcy law limits assignment of a rent-stabilized lease, bankruptcy should not create a right not held by the landlord outside of bankruptcy. *See Butner*, 440 U.S. at 55 ("Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving a windfall merely by reason of the happenstance of bankruptcy.") (internal citations omitted).

Courts have repeatedly recognized that the purpose of 11 U.S.C. § 365 is to make "the debtor's rehabilitation more likely" by allowing a debtor to relieve the estate of burdensome obligations while providing a means to ensure that profitable arrangements may be maintained despite the bankruptcy filing. *Richmond Leasing Co. v. Capital Bank, N.A.*, 762 F.2d 1303, 1310 (5th Cir. 1985) (*per curiam*); *see also In re Chateaugay Corp.*, 10 F.3d 944, 954 (2d Cir. 1993) (*citing Richmond Leasing*, 762 F.2d 1303). Section 365 balances a debtor's fresh start with the interests of creditors by allowing for rejection of burdensome obligations and assumption of profitable or beneficial agreements. *In re Friarton Estates Corp.*, 65 B.R. 586, 588 (Bankr. S.D.N.Y. 1986) (denying bankrupt landlord's motion to reject rent-regulated leases). This point is routinely made in debtor-in-possession

cases, such as *Friarton Estates* and *Chateaugay*, but should guide courts as well in Chapter 7 cases: § 365 does not guarantee the right of a trustee to maximize value for the estate at the expense of the debtor's fresh start. *See Lichtenstein*, 238 B.R. 249, 255 (holding that rejection of a rent-stabilized lease under § 365(g) does not constitute a termination of that lease, but rather an abandonment of the lease to the debtor). Here, it cannot be asserted as it was in *Resolution Trust Corp. v. Diamond* that the rent stabilization law "interferes with the methods by which the federal statute was designed to reach [its] goal," especially because there is no provision in the Bankruptcy Code itself that compels the action the Trustee seeks to take. 45 F.3d 665, 676 (2d Cir. 1995) (finding that federal Financial Institutions Reform, Recovery, and Enforcement Act of 1989 specifically preempted New York state anti-eviction laws).

The decisions below allow an unexpected windfall for the creditors of rent-stabilized tenants with no assets, because the creditors could never reach the value of the debtor's rent-stabilized apartment outside of bankruptcy. Likewise, these decisions allow an unexpected windfall for certain debtors' landlords, who will benefit from the eviction of rent-stabilized tenants by re-letting or selling their apartments, likely for great profit, even if the debtor-tenants continue to pay their rent and otherwise occupy their apartments in full compliance with New York State law. Assignment of a rent-stabilized lease, a procedure simply not

contemplated by New York State law or the Bankruptcy Code, leads inexorably to the perverse result of eviction of a lawful tenant from his or her home. This result subverts the legislative intent of the rent-stabilization laws, which seek to provide permanency to tenants who pay rent and abide by their obligations, and compromises the goals of the bankruptcy laws, which provide a fresh start to debtors.

Recognizing that § 365 can have unintended collateral consequences at odds with the Bankruptcy Code's policies, courts have thwarted attempts to assume and assign or to reject when permitting such actions would distort the outcomes intended by the Code. *See In re Bygaph, Inc.*, 56 B.R. 596, 605 (Bankr. S.D.N.Y. 1986) ("[T]he assumption and assignment process is not designed to afford a landlord with a benefit in addition to that which he originally bargained for under the original lease"); *In re Prime Motor Inns*, 166 B.R. 993 (Bankr. S.D. Fla. 1994) ("[T]he objective of Section 365 of the Bankruptcy Code is to protect the landlord, not to improve its position") (approving assumption where denying assumption would return leased premises to landlord, materially improving landlord's position and prejudicing debtors). Courts protect debtors in other contexts under the Code – for example, in determining whether to approve or reject reaffirmation agreements. In such cases, courts routinely rule in favor of preserving the debtor's fresh start, even over objections from the debtors themselves. *See, e.g., Matter of*

Avis, 3 B.R. 205 (Bankr. S.D. Ohio 1980) (rejecting reaffirmation agreement between debtors and credit union where "[a]pproval of the submitted reaffirmation would violate the basic principles guiding bankruptcy relief, the effectiveness of discharge would be weakened; and all creditors would not be treated substantially alike"). Bankruptcy courts should exercise their equitable powers to deny motions to assume and assign rent-stabilized leases for the profit of landlords, bankruptcy trustees, and creditors.

II. PERMITTING ASSUMPTION AND ASSIGNMENT OF A RENT-STABILIZED LEASE IN BANKRUPTCY COMPROMISES THE INTEGRITY OF THE RENT-STABILIZATION LAWS AND REGULATIONS

A. The rent stabilization laws and regulations prohibit, and courts have routinely thwarted, attempts to circumvent the regulatory regime.

While the bankruptcy court characterized a tenant's rights under the rent stabilization laws as a mere "quirk of the regulatory scheme in the New York housing market," 466 B.R. 621, 625 (2012), rent stabilization in fact covers nearly half of all rental apartments in New York City. FURMAN CENTER REPORT 1. Far more than a "quirk," the rent stabilization laws have repeatedly been reenacted and amended to afford tenants continued protection against "exactions of unjust, unreasonable and oppressive rents and rental agreements and to forestall profiteering, speculation and other disruptive practices tending to produce threats to the public health, safety and general welfare." N.Y.C. Admin. Code § 26-501

(renewed and extended 2011). The regulations have also withstood constitutional challenges in the federal courts. *Harmon v. Markus*, 412 F. App'x 420 (2d Cir. 2011) (rejecting landlords' claims under the takings, contracts, due process, and equal protection clauses), *cert. denied sub nom Harmon v. Kimmel*, 132 S. Ct. 1991 (2012).

The rent-stabilization law provides thorough protections to maintain affordable housing and ensure that tenants are not displaced. Apart from the restrictions on rent increases, at the heart of the protections available to tenants under New York City's Rent Stabilization Law (RSL) is the right to a renewal lease granted by 9 N.Y.C.R.R. § 2524.1. *See also Caine v. Carreker*, 116 Misc. 2d 419, 457 N.Y.S.2d 682 (App. Term 1st Dep't 1982) ("The right to a renewal lease is one of the cornerstones of the rent stabilization system."). Unlike ordinary leaseholds, a rent-stabilized lease must be renewed unless a tenant has violated his or her obligations; the landlord cannot evict a rent-stabilized tenant who pays rent on time absent the existence of other very limited circumstances (malicious damage to the housing accommodation, for example, or use of the accommodation for an illegal purpose). 9 N.Y.C.R.R. § 2524.1, 2524.3. As a further measure to preserve the number of rent-stabilized apartments in New York City, even consensual agreements between a landlord and tenant to waive the rent stabilization laws are void. 9 N.Y.C.R.R. § 2520.13; *see also Drucker v. Mauro*,

30 A.D.3d 37, 814 N.Y.S.2d 43 (App. Div. 1st Dep't 2006) (holding that waiver is prohibited even where agreement allegedly benefited tenant).

Together, these restrictions demonstrate a concerted effort by the New York State legislature, the New York City Council, and the state and federal courts to preserve the rent stabilization system for the benefit of millions of New York City residents. A bankruptcy trustee's attempt to assume and assign a rent-stabilized lease poses a profound threat to the stability of this system.

B. Permitting assignment of a rent-stabilized lease in bankruptcy constitutes an impermissible end run around these prohibitions.

Authorizing the course of action proposed by the Trustee in this case would sanction something impermissible, indeed criminal, under New York State and local law. Displacing a tenant who pays rent on time and fulfills all other obligations under a rent-stabilized lease strikes at the heart of the tenant protections in the rent stabilization laws.

Nothing in the rent stabilization laws allows a landlord to recapture an apartment from a responsible, paying tenant. The trustee's proposed action must be viewed in light of applicable non-bankruptcy law. *BFP*, 511 U.S. 531; *Butner*, 440 U.S. 48. Selling a lease is prohibited by the rent stabilization laws, *see* 9 N.Y.C.R.R. §§ 2525.1 (prohibiting demand or receipt of rent in excess of regulated amount for rent-stabilized apartments), 2525.6 (prohibiting sublessors from charging more than legal regulated rent for rent-stabilized apartments; providing

treble damages for sublessees), and accepting payment in exchange for an agreement that such payment will "increase the possibility that any person may obtain . . . the lease, rental or use of such property" constitutes a Class A misdemeanor under New York State law. N.Y. PENAL LAW § 180.56. Bankruptcy courts should respect the policy and authority of New York State's regulatory scheme on these matters, and should not permit an act that would be illegal and quite possibly criminal under New York State law.

CONCLUSION

For the reasons set forth above, this Court should reverse the order of the District Court granting the trustee's application to strike the debtor's exemption and hold that a rent-regulated lease is exempt from the bankruptcy estate.

Date: January 30, 2013
New York, New York

Respectfully submitted,

_____/s/_____

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1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 5,154 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

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New York, New York

_____/s/_____
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