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Consumer Track

Can Debtors Have Their Cake and Eat It Too Under § 521?

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Introduction

- *In re Failla*, 838 F.3d 1170 (11th Cir. 2016).
- Issue: Whether a debtor who agrees to surrender his or her home in bankruptcy may oppose foreclosure action in state court.

First things first: Why does a debtor surrender property under § 521?

- Property is burdensome
 - Debt service
 - “Incidences of ownership”
 - Taxes
 - Insurance
 - Maintenance
 - HOA fees



Text of § 521(a)(2) as follows:

The debtor shall—
...

(2) if an individual debtor's schedule of assets and liabilities includes debts which are secured by property of the estate—

(A) within thirty days after the date of the filing of a petition under chapter 7 of this title or before the date of the meeting of creditors, whichever is earlier, or within such additional time as the court, for cause, within such period fixes, **file with the clerk a statement of his intention with respect to the retention or surrender of such property and, if applicable, specifying that such property is claimed exempt, that the debtor intends to redeem such property, or that the debtor intends to reaffirm debts secured by such property;** and

(B) within 30 days after the first date set for the meeting of creditors under section 341(a), or within such additional time as the court, for cause, within such 30-day period fixes, perform his statement of intention with respect to such property, as specified by subparagraph (A) of this paragraph;

except that nothing in subparagraphs (A) and (B) of this paragraph shall alter the debtor's or the trustee's rights with regard to such property under this title, except as provided in section 362(h);



Official Form 108

Statement of Intention for Individuals Filing Under Chapter 7

12/15

If you are an individual filing under chapter 7, you must fill out this form if:

- creditors have claims secured by your property, or
- you have leased personal property and the lease has not expired.

You must file this form with the court within 30 days after you file your bankruptcy petition or by the date set for the meeting of creditors, whichever is earlier, unless the court extends the time for cause. You must also send copies to the creditors and lessors you list on the form.

If two married people are filing together in a joint case, both are equally responsible for supplying correct information.

Both debtors must sign and date the form.

Be as complete and accurate as possible. If more space is needed, attach a separate sheet to this form. On the top of any additional pages, write your name and case number (if known).

Part 1: List Your Creditors Who Have Secured Claims

1. For any creditors that you listed in Part 1 of *Schedule D: Creditors Who Have Claims Secured by Property* (Official Form 106D), fill in the information below.

Identify the creditor and the property that is collateral	What do you intend to do with the property that secures a debt?	Did you claim the property as exempt on Schedule C?
Creditor's name: _____ Description of property securing debt: _____	<input type="checkbox"/> Surrender the property. <input type="checkbox"/> Retain the property and redeem it. <input type="checkbox"/> Retain the property and enter into a <i>Reaffirmation Agreement</i> . <input type="checkbox"/> Retain the property and [explain]: _____	<input type="checkbox"/> No <input type="checkbox"/> Yes
Creditor's name: _____ Description of property securing debt: _____	<input type="checkbox"/> Surrender the property. <input type="checkbox"/> Retain the property and redeem it. <input type="checkbox"/> Retain the property and enter into a <i>Reaffirmation Agreement</i> . <input type="checkbox"/> Retain the property and [explain]: _____	<input type="checkbox"/> No <input type="checkbox"/> Yes
Creditor's name: _____ Description of property securing debt: _____	<input type="checkbox"/> Surrender the property. <input type="checkbox"/> Retain the property and redeem it.	<input type="checkbox"/> No <input type="checkbox"/> Yes

Framing the issue for *Faila*:***In re Taylor*, 3 F.3d 1512 (11th Cir. 1993).**

- First, the 11th Circuit interpreted 521(a)(2) as *providing a debtor with 3 options*:
 1. Surrender the property,
 2. Retain and reaffirm the debt, or
 3. Retain and redeem the debt
- Second, Court espoused underlying principle to support its interpretation of 521(a)(2): *it is unfair/inequitable to allow a debtor to receive discharge and retain property.*



Taylor Takeaways

- Debtor must redeem or reaffirm if he retains secured property.
- “Allowing a debtor to retain property without reaffirming or redeeming **gives the debtor not a ‘fresh start’ but a ‘head start’** since the debtor effectively converts his secured obligation from recourse to nonrecourse with no downside risk for failing to maintain or insure the lender's collateral.”



Focusing on *Failla*

- ***The court held that defending a foreclosure action is inconsistent with choosing surrender.***
- When a debtor chooses to surrender, “the debtor must drop his opposition to the creditor’s subsequent foreclosure action.”
- The Faillas could not contest the foreclosure action because they chose surrender.
- Furthermore, the court has the power to compel the Faillas to not oppose the foreclosure action.





Failla, cont.

- ***Failla* takeaways:**
 - Defending a foreclosure action post-surrender is inconsistent with a debtor's Statement of Intention to surrender real property.
 - A bankruptcy court may compel a debtor to stop defending a state foreclosure action.



Failla relies upon: ***Trussel & Sullivan-Anderson***

- *In re Trussel*, 2015 WL 1058253 (Bankr. N.D. Fla. 2015).
- *In re Sullivan-Anderson*, 307 B.R. 726 (Bankr. M.D. Fla. 2003).
- In both cases, the trial court's focus was on the debtor's efforts to comply with the Statement of Intention.
 - It's a simple question: did you reaffirm? If not, then surrender the property.
- *The Trussel* court indicates that stay relief is the most appropriate remedy where a debtor doesn't comply with her Statement of Intention to reaffirm.



Post-Failla 11th Circuit Decision

- *Jones v. Citimortgage, Inc.*, 666 F. App'x (11th Cir. 2016).
- "Without reaffirming the debt or redeeming the collateral, the debtor has no right to retain the collateral...though the debtor can continue to maintain mortgage payments on a principal residence after discharge without reaffirming the debt, and a creditor can take such payments rather than pursue an *in rem* foreclosure, see 11 U.S.C. § 524(j)."
- *Jones* tends to support the *Failla* holding that because the debtor did not reaffirm or redeem the property, debtor has no basis to challenge foreclosure action.



Are surrender, redeem, or reaffirm a debtor's only options?

- **Ride-through:** debtor can retain real property without being required to redeem or reaffirm, so long as he or she remains current on payments and complied with other contractual obligations
- **4th Circuit:** Ride-through allowed
 - *In re Wilson*, 372 B.R. 816 (Bankr. D.S.C. 2007).
 - *In re Lopez*, 440 B.R. 447 (Bankr. E.D. Va. 2010).
- **11th Circuit:** Ride-through prohibited
 - *In re Linderman*, 435 B.R. 715 (Bankr. M.D. Fla. 2009).
 - *In re Harris*, 421 B.R. 597 (Bankr. S.D. Ga. 2010).



In re Ryan – a contrary holding

- *In re Ryan*, 560 B.R. 339 (Bank. D. Haw. 2016).
- Like the *Failla* court, *Ryan*, the court was tasked with determining what it means to surrender property in bankruptcy.
- The *Ryan* court concluded a debtor may *fight disclosure despite their filing of a Statement of Intention to surrender the property*. This appears to be opposite of the *Failla* ruling.
- But is this actually opposite of *Failla*? Can you reconcile the *Ryan* court's holding to make it consistent with *Failla*?



Failla and its relation to HOAs

1. **Non-dischargeability** of post-petition HOA fees in Chapter 7 cases.
 - 11 U.S.C. § 523(a)(16): Any post-petition fee or assessment owed to an HOA while there is legal or equitable ownership of the property by the debtor will continue to be the personal liability of the debtor.
 - The longer a debtor holds onto the property and tries to fight a foreclosure, the greater the HOA's fees could be.
2. **Surrender:** Required to "get out of the way." That would include not dodging service in judicial foreclosure lawsuits filed by the HOA.
3. **Reaffirm:** Does this constitute an admission that a debtor owes something to the HOA?
4. **Failing to list entirely:** Could lead to a Motion to Compel.



Failla and its relation to HOAs, cont.

- **Homeowners association liens are secured by real property either by:**
 - Common law land covenants, filed notices of lien, statutory liens, or court-ordered judicial liens.
- **Is an HOA lien on property a liability? (521(a)(1)(B)(i))**
 - Debtor must file a "schedule of assets and liabilities."
 - An HOA lien on real property is a liability on an asset of the debtor, and it must be listed.
 - Failure to file a complete list of assets and liabilities on sworn schedules may constitute bankruptcy fraud, perjury, and subject a case to automatic dismissal under 11 U.S.C. § 521(i)(2) for not filing items on the required list within 45 days of a petition filing.



Failla and its relation to HOAs, cont.

- **What kind of claim does an HOA have in a chapter 7 case?**
 - Court determines the secured and unsecured value of liens, but only where there are "allowed claims" filed.
 - Most Chapter 7 "no asset" cases do not have a claims filing process, so the liens remain attached to the property. *Bank of America v. Caulkett*, 135 S. Ct. 1995 (2015).
 - Statute requires that the lien's "value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use...affecting such creditor's interest."
 - Key takeaway: Unless there is a hearing that determines otherwise, then the lien should be considered secured by the property unless and until a court orders otherwise.



Failla and its relation to HOAs, cont.

- **What about HOAs and the Statement of Intention, 521(a)(2)?**
 1. In a no asset case, since § 521(a)(1)(B)(i) and 506(a) leave an HOA creditor with a secured claim against property in bankruptcy, the property and its intended disposition must be listed on the Statement of Intention.
 2. “Forgotten Liens”: Many debtors fail to list an HOA creditor and its lien on the Statement of Intention.
 3. Code gives only three options: Redeem, Reaffirm, or Surrender.
 - a. Redemption: Pay off the lien and start fresh.
 - b. Reaffirm: Prevent the HOA from taking post-discharge action to foreclose upon the lien.
 - c. Surrender: Allow the HOA to exercise its *in rem* lien rights without interference. *In re: Failla*, 838 F.3d 1170



Debtor has surrendered – now what?

- General consensus: when a debtor surrenders property under either § 521(a)(2) or § 1325(a)(5)(C), the debtor relinquishes his or her rights to the collateral in favor of the creditor



Can a Chapter 7 or 13 debtor force a creditor to take title to surrendered property?

- *Pratt v. GMAC (In re Pratt)*, 462 F.3d 14 (1st Cir. 2006)
- General meaning of "surrender": make collateral available to creditor
- The Pratts' surrender did not require that the creditor repossession the vehicle.



Why won't the creditor just foreclose already?

- Cost of repossession > value of property
- Burdens of property ownership
- Other sources of recovery
- Environmental issues - *In re Gollintz*, 456 B.R. 733 (Bankr. W.D.N.Y. 2011).
- Public nuisance - *In re Phillips*, 368 B.R. 733, 743 (Bankr. N.D. Ind. 2007).
- Property loss - *In re Koeller*, 170 B.R. 1019 (Bankr. W.D. Mo. 1994).



Limits of creditor action/inaction

***In re Pratt*: No objectively coercive behavior**

- Inoperable and worthless vehicle
- Creditor did not repossess
- State law: cannot junk vehicle without lien release
- Creditor refused to release lien unless balance paid in full
 - Unqualified right under state law
- Held: **refusing to release lien unless balance paid in full, without compelling reason to rely on its bare right of refusal, amounted to objectively coercive behavior in violation of discharge injunction**
- Key quote: "even legitimate state-law rights exercised in a coercive manner might impinge upon the important federal interest served by the discharge injunction, which is to ensure that debtors receive a 'fresh start' and are not unfairly coerced into repaying discharged prepetition debts."



Debtor Remedies

- **Forced sale of surrendered property?**
- ***In re Pigg***, 453 B.R. 728 (Bankr. M.D. Tenn. 2011)
 - Debtor sought to compel mortgagee to either accept deed in lieu of foreclosure or to instigate foreclosure proceeding. Court held that equity required a remedy which would prevent eradication of debtor's fresh start.
 - Bankruptcy court can use 105(a) to force a creditor to consent to a sale under 363(f)(2) when the creditor affirmatively objects to such a sale
- *But see In re Fristoe*, 2012 WL 4483891 (Bankr. D. Utah Sept. 27, 2012)



Debtor Remedies, cont.

- **Court authorized delivery of quitclaim deed to creditor?**
- *In re Perry*, No. 12-01633-8-RDD, 2012 WL 4795675 (Bankr. E.D.N.C. Oct. 9, 2012).
 - Debtor desires to surrender the real property to creditor. Court granted Creditor reasonable amount of time to commence special proceeding to foreclose the Promissory Note secured by Deed of Trust – if does not act timely, then Debtor is authorized to convey title by quitclaim deed to Creditor.
- *But see In re Cormier*, 434 B.R. 222 (Bankr. D. Mass. 2010); *In re Phillips*, 368 B.R. 733 (Bankr. N.D. Ind. 2007); *In re Harris*, 244 B.R. 556 (Bankr. D. Conn. 2000).



Debtor Remedies, cont.

- **Creditor takes possession or control of surrendered property?**
- Big caveat
- Numerous decisions hint that had creditor taken possession, courts could use § 105 powers to shift some of the incidences of ownership to creditor
- Judge Leonard: court retains its discretion to “insure that creditors act reasonably to exercise their rights under state law,” with regard to proceeding expeditiously in a foreclosure action. *In re Belardinelli*, No. 12-02891-8-JRL, Doc. 78 (Bankr. E.D.N.C. Feb. 21, 2013).



Best Practices

- What do you advise your clients who want to retain property these days? Reaffirm or file ch. 13? Ch. 13 surrender but include retention of state law rights in plan?
- What's your best practice tip or takeaway from *Failla*? Creditors - can use bankruptcy court to enforce debtor's obligation to surrender property, but should consider judicial estoppel in state court and whether an order compelling compliance will quickly resolve issues.



Questions?

