NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

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REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)

Loan Servicer When Taxes Are Due Is Responsible Under RESPA for Those Taxes [4TH CIR]

The debtor took out a federal mortgage with the creditor (Creditor 1) in which the mortgage agreement required the debtor to pay real estate taxes to an escrow account with a servicer, in this case Creditor 1, a practice allowable under RESPA. RESPA also requires a servicer of a mortgage when a tax payment is due to make that tax payment. Accordingly, servicers are obligated to pay the taxes on time. The mortgage agreement also allowed for Creditor 1 to sell the mortgage and transfer the rights to service the mortgage. After the debtor's tax payment was in the escrow account, Creditor 1 sold the mortgage and the rights to service the mortgage to a different creditor (Creditor 2). Both creditors failed to pay the tax on time. Although Creditor 2 paid the late fees the debtor was penalized on his income taxes and initiated this action. The question before the court was which creditor was responsible for making the tax payment on time.

In HARRELL v. FREEDOM MORTG. CORP., 976 F.3d 434 (4th Cir. 2020), the court held that because the debtor plausibly alleged Creditor 2 was the servicer at the time the taxes became due the claim could proceed. RESPA requires that the entity responsible for servicing a mortgage when a tax payment is due make that payment, not the servicer that receives the escrow payment for the tax payment. The court reasoned that when interpreting a statute, it must be read in its "ordinary, contemporary, and common meaning." The reading of the statute suggests the servicer must pay the taxes when they become due and the servicer is also responsible for making the tax payment on time. Because the debtor was able to show the Creditor 2 had received the right to service the loan before the taxes were due the case could proceed. *[By Caytlin Pichla Ed. Grant Coffey]*

Dude, Where's My Car? Chapter 13 Debtor May Modify Rights of Pawnshop [BKR MD AL]

Debtor entered into a contract with pawnshop for a loan. Debtor pledged the title to a vehicle in exchange for the loan. Ten days before the maturity date of the loan, the debtor filed a chapter 13 bankruptcy petition. The debtor's chapter 13 repayment plan proposed to repay the debt to the creditor-pawn company. The creditor objected to this repayment plan, arguing that the right to redeem the vehicle became a part of the estate at the commencement of the case but ceased to be property of the estate once the redemption period expired. Thus, the creditor claimed it owned the car at the maturity date of the loan. The debtor rejected this claim- and asserted he held legal title to the car, and the pawnshop-creditor only held a modifiable security interest.

In IN RE WOMACK 616 B.R. 420 (U.S. Bankr. M.D. Ala., June 9, 2020), the court evaluated the perfected interest of the pawnshop-creditor to determine the modifiability of the interest. The court held that pawn transactions under Alabama law remain nonrecourse loans. However, despite being nonrecourse, the loan still creates a debtor-creditor relationship. As a result, until the debtor defaults on the contract creating the loan, the pawnshop-creditor has no available remedy. Accordingly, the debtor retains legal title to a pawned vehicle before the maturity date of the loan occurs. The contract between pawnshop-creditor and debtor only gives the creditor an interest in taking possession of the vehicle upon default. This security interest, found in the contract between the parties titled "Pawn Ticket and Security Agreement," merely gave the creditor a lien and a security interest. Considering these interests, the modification of the security interest in chapter 13 is permissible under 11 U.S.C. § 1322(b)(2). The court cited to two cases in other circuits in which this had occurred. Because the chapter 13 filing occurred before the default on the agreement, the property interests that became property of the estate were ownership rights, rather than rights of redemption.

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The court rejected the claim of the pawn-creditor that previous case law was controlling. The difference between this case and the cases relied upon by the pawnshop creditor was the date the suit was filed. In the case cited by the creditor, the debtor had allowed the maturity date to lapse prepetition. Here, the debtor did not let the maturity date lapse and filed his chapter 13 case before the redemption period. Therefore, at the time of filing the creditor merely held a modifiable security interest. The court ruled in favor of the debtor, overruling the objection to the confirmation of the debtor's chapter 13 plan and allowing the plan to be confirmed. *[By Jimmy D.Vaughn jimmy.d.vaughn@ttu.edu Ed. Grant Coffey]*

Debtor Could Not Compel Creditor to Repossess Vehicle [BKR ED MI]

Debtor borrowed money to buy a car from creditor and secured the loan with the car. Later the debtor fell on hard times and voluntarily filed for chapter 13 bankruptcy. The debtor's chapter 13 plan provided that the debtor would surrender the car (which was of nominal value) to the creditor. After the creditor refused to take the vehicle, the debtor sought to force the creditor to repossess the vehicle or release its lien on the vehicle. The creditor filed no papers in response to the motion.

In IN RE LOUCKS, 618 B.R. 908 (Bankr. E.D. Mich. 2020), the court held the debtor could not require the creditor to repossess the vehicle or release its lien. While the creditor could do so if it wished, under the chapter 13 plan, the creditor could not be compelled to do so. The chapter 13 plan only provided that the debtor would surrender the vehicle. The court determined the term "surrender" is "a procedural device that permits the secured creditor to pursue its state law remedies with regard to the property surrendered". The term did not force the creditor to take the vehicle or release its lien. Rather, the creditor only has the "substantive right" to do so if it wishes. *[By Matthew Fosheim matthew.fosheim@ttu.edu Ed. Kurt Brown]*

BANKRUPTCY

Debtor's Chapter 13 Plan Improperly Sought to Modify Bank's Rights in Violation of Bankruptcy Code [3D CIR]

A debtor obtained a loan to purchase his principal residence. The debtor later sought protection under chapter 13 of the Bankruptcy Code and filed a First Amended chapter 13 Plan, followed by a Second Amended Plan ("Plan"), proposing to satisfy the bank's secured claim by making payments up to the stipulated market value of the property. The bank, however, objected to the Plan. The debtor then filed an adversary proceeding against the bank, arguing that: (1) the bank's claim was unsecured, as it represented the excess of the market value of the residence, and was void; and (2) the Plan was valid under § 1325 and did not modify the bank's claim under § 1322(b)(2). The Bankruptcy Court granted summary judgment to the bank, holding that the Plan's proposed treatment of the bank's secured claim violated § 1322(b)(2), and directed the debtor to file a Plan that did not modify the bank's rights. The debtor appealed to the District Court, and the District Court affirmed the bankruptcy court.

In JONES v. U.S. BANK, N.A. (IN RE JONES), Fed. App'x, 2020 WL 5846428, 2020 U.S. App. LEXIS 31189 (3d Cir. Oct. 1, 2020) (opinion not yet released for publication), the appellate court held that the debtor's plan improperly sought to modify the bank's rights in violation of § 1322(b)(2) of the Bankruptcy Code. First, the court evaluated whether a debtor may "modify the rights of holders of secured claims ... secured only by a security interest in real property that is the debtor's principal residence." 11 U.S.C. § 1322(b)(2). A debtor cannot change the terms of a mortgagee's rights where those rights are secured only by the debtor's principal residence. Nobelman v. Am. Sav. Bank, 508 U.S. 324, 331 (1993). In proposing to pay the bank's claim up to the market value of the debtor's principal residence plus a reduced interest rate rather than the full contract balance, the debtor sought to modify, not satisfy, the bank's contractual rights. The debtor's proposal drastically changed the principal and the interest rate due, and thus modified the bank's contractual rights, which Nobelman and § 1322(b)(2) prohibit. Second, the court evaluated whether the debtor's plan was confirmable under the Bankruptcy Abuse and Consumer Protection Act's amendment to § 1325(a). The court stated that this amendment did not apply to liens on a principal residence and it still required a plan that complied with other provisions of chapter 13, including § 1322(b)(2). As a result, because the debtor's plan improperly sought to modify the bank's rights in violation of § 1322(b)(2), the District Court correctly granted the bank's motion for summary judgment. *[By Carlos Gracia carlos.gracia@ttu.edu Ed. Melissa Clark]*

Bankruptcy Court Shall Grants Relief From Stay in Fourth Case [3D CIR]

The debtors defaulted on a mortgage. and the day before the scheduled foreclosure, filed a chapter 13 bankruptcy petition. That petition was the debtors' fourth petition attempting to "delay or cease the foreclosure proceedings through the automatic stay under 11 U.S.C. § 362(a) ." In response, the creditor filed a motion for in rem relief from the automatic stay, which the court granted. One of the debtors, the wife, filed an appeal from that order.

In IN RE KAJLA, 824 F. App'x 92, 2020 U.S. App. LEXIS 31387 (3rd Cir., Oct. 2, 2020), the court noted that 11 U.S.C § 362(d)(4) mandates that a bankruptcy court grant relief from a stay if it finds that the petition's filing was part of a scheme "to delay, hinder, or defraud creditors that involved. . . multiple bankruptcy filings affecting such real property." The court determined that, given the factual record, the lower court did not err in granting the creditor's motion for in rem relief. The debtor admitted that her spouse had previously filed for bankruptcy to protect assets from foreclosure. The debtor argued that these previous proceedings had prejudiced the court against her; however, the court found her argument unsupported by fact and not persuasive. In such context, the court held relief from the stay was appropriate in a bankruptcy case because the filing was for the purpose of delaying and defrauding creditors. *[By Madison Pyle madison.pyle@ttu.edu Ed. Grant Coffey]*

Debtor Incorrectly Believed She Could Avoid Her Home Mortgage Payment By Filing for Chapter 13 Bankruptcy [BKR ND IL]

A debtor whose primary assets included her home filed chapter 13 bankruptcy. The home had passed through several banks and creditors through reassignment of the mortgage before the bankruptcy occurred. On July 10, 2020 one bank claimed to be the lawful owner of the note and mortgage. However, the statement proved false because the bank did not receive the note until July 27, 2020. A second bank was the actual holder of the note at the time of bankruptcy. The banks sought to file an amended claim and correct the defect in the initial proof of claim. Instead of arguing that her debts had been fully paid, the debtor argued the note transfer was impermissible and unenforceable. Therefore, the debtor argued she did not have to make any further mortgage payments on the home loan.

In IN RE WILLIAMS, 622 B.R. 54 (Bankr. N.D. Ill. 2020) the court held although the proof of claim was incorrect it did not absolve the debtor from all future mortgage payments. The court's opinion begins by stating, "Making legal decisions based on incorrect assumptions about the law is a significant risk for pro se debtors." The debtor argued several points in support of her argument that she no longer owed mortgage payments. The majority of her arguments were flatly rejected by the court. However, the debtor correctly argued the first bank's proof of claim should be rejected because that entity had not yet held the note at the time the claim had been filed. "A proof of claim is a written statement setting forth a creditor's claim." Fed. R. Bankr. P. 30l(a). Once a debtor challenges a creditor's claim, the creditor must show proof that the note is enforceable. The bank sought to amend its claim within the time period allowed under Bankruptcy Rule 3002(c)(7). However, it was too late for the bank to supplement its claim on the note. Nevertheless, the invalidity of the proof of claim did not invalidate the obligations of the debtor on the secured obligation. First, the debtor already admitted that the original debt that remained unsatisfied. Second, a secured claim remains unaffected by bankruptcy even when a secured creditor files no proof of the claim at all. This meant that, assuming the debtor received her discharge, the holder of the note "could not pursue any deficiency judgment against her." Thus the court speculated the debtor could either argue that her failure to file a claim on behalf of the holder of the mortgage on the note was the result of "excusable neglect" given the circumstances of the case or lose the house in foreclosure without any liability for any deficiency judgment. *[By Matthew Fosheim matthew.fosheim@ttu.edu]*

Debtor's Failure to Make Post-Petition Mortgage Payments Allowed Foreclosure After Lifting an Automatic Stay [BKR ND GA]

A debtor voluntarily filed for chapter 13 bankruptcy. The debtor's most valuable asset was her home. The creditor, who held the note on the home, filed a claim citing the debtor's failure to make continual payments on the home according to the bankruptcy schedule. In response, the debtor claimed the creditor did not hold a valid lien on the property. The debtor filed a motion for a hearing on the issue, and successfully received a stay on the creditor's actions as to her homestead property. The court's decision further provided that the debtor escrow her regular monthly payments. The debtor continued to argue against the creditor's claims and made no monthly payments for over two years. In response, the creditor sought relief from the stay.

In IN RE HUGHES, No. 17-52260-LRC, 2020 Bankr. LEXIS 2167 (Bankr. N.D. Ga. Aug. 11, 2020), the court held the creditor could foreclose on the property because the debtor failed to make any post petition mortgage payments. Because the debtor had "no intention of providing for the Claim or the lien in the Plan," the court held the creditor had "cause" to lift the automatic stay and could be granted relief. *[By Matthew Fosheim matthew.fosheim@ttu.edu Ed. Grant Rodgers]*

When Bankruptcy Trustee Abandons Cause of Action, Standing to Bring Suit Reverts to Original Creditor [3D CIR]

A debtor purchased goods from a vendor and but never paid for them. The vendor sued the debtor and obtained a judgment against the debtor, which was recorded as a lien against a valuable warehouse belonging to the debtor. Soon after, the vendor discovered that the debtor was insolvent. Its former owner had hatched a plot with its outside counsel and one of its previous creditors to plunder the company's assets. The vendor then sued the previous creditor and the outside counsel. Two months later, the debtor filed for bankruptcy and quickly exhausted the bulk of its remaining assets. The bankruptcy trustee then asked the court to issue an Abandonment Order, which included the vendor's remaining claims against the previous creditor and the debtor's outside counsel. These claims were being pursued in the district court but were eventually referred to the debtor's bankruptcy case because those claims, the district court reasoned, were "related to" the bankruptcy. The bankruptcy court (and eventually the district court) dismissed the vendor's claims altogether. The court held that the Abandonment Order did not grant the vendor "standing to sue" because it was up to the trustee to bring all claims that are "derivative of harm that the [previous creditor and outside counsel] had inflicted on [the debtor]." The vendor appealed to the Third Circuit.

In ARTESANIA HACIENDA REAL S.A. DE C.V. v. NORTH MILL CAPITAL, LLC (IN RE WILTON ARMETALE, INC.), 968 F.3d 273 (3d Cir. 2020), the court held that even though the bankruptcy had deprived the vendor of its standing to sue the previous creditor and the debtor's outside counsel, the trustee's Abandonment Order had resurrected that standing. The court distinguished between constitutional and statutory standing, ruling that the vendor maintained constitutional standing under the Supreme Court's test in Lexmark Int'l, Inc. v. Static Control Components, Inc., 572 U.S. 118 (2014). However, the vendor did not have statutory standing under the Bankruptcy Code because its claims were derivative of harm to the debtor's estate and therefore could only be prosecuted by the bankruptcy trustee. Once the bankruptcy court granted the Abandonment Order, though, the circuit court reasoned that just like an estate's chattels and assets, its causes of action became transferrable property. Once those causes of action were overtly relinquished by the trustee, the right to prosecute reverted to the party that held the right in the first place. Therefore, the Abandonment Order resurrected the Vendor's claims against the previous creditor and the debtor's outside counsel. *[BLB086 By Will Watson will.watson@ttu.edu Ed. Matthew Fosheim]*

Debtor Ineligible for Chapter 13 Bankruptcy Under 11 U.S.C. § 109(e) [BKR WD WI]

The debtor was a sole member of a limited liability company (" LLC"). The LLC had three loans with a bank secured by all the LLC's assets. The debtor personally guaranteed the loans to the LLC but did not pledge any personal assets to secure the loans. The LLC defaulted on its loans. The bank filed a lawsuit against the LLC and sought the appointment of a receiver under Wisconsin law. On the day of the receivership hearing, the debtor dissolved the LLC and assigned all the assets and debts to the debtor, as a sole member of the LLC, in order to stay the bank's attempts to replevin the business assets. On the same day, the court appointed a receiver at the end of the hearing and the debtor filed a personal chapter 13 petition. The bank filed a motion to dismiss the debtor's chapter 13 case for "cause" under 11 U.S.C. § 1307(c).

In IN RE FRIEDRICH, 618 B.R. 274 (Bankr. W.D. Wis. 2020), the court granted the bank's motion to dismiss the debtor's chapter 13 case. The court stated that chapter 13 bankruptcies are generally reserved for small debtors who seek to retain their property while making scheduled payments. Under 11 U.S.C. § 109(e) a chapter 13 debtor must hold noncontingent, liquidated, unsecured debts of less than $419,275, this debtor had greater obligations. Bankruptcy Code § 1307(e) allows for the dismissal of a Chapter 13 case "for cause." While bankruptcy courts within the Seventh Circuit have found a debtor ineligible for a Chapter 13 bankruptcy under section 109(e), the Seventh Circuit has not explicitly stated that ineligibility under section 109(e) constitutes "cause" under 11 U.S.C. § 1307. However, the court stated that the Seventh Circuit implicitly confirmed that ineligibility is grounds for dismissal by affirming the lowers courts' dismissal of cases where debtors were held ineligible for chapter 13 bankruptcies under section 109(e). Further, under section 1307(c), the bankruptcy court has discretion to dismiss a chapter 13 case. Thus, the court dismissed the debtor's chapter 13 bankruptcy petition. *[By Sonam James sonam.james@ttu.edu Ed. Melissa Clark]*

FEDERAL DEBT COLLECTION PRACTICES ACT (FDCPA)

Secured Party's Breach of the Peace Could Lead to FDCPA Violation [WD NY]

A lender contracted with a thirdparty towing service to repossess the debtor's car. The debtor alleged that the towing service, while repossessing her car, rammed her gate, causing significant property damage. When the debtor went outside her home and objected to the towing service's actions, an employee of the towing service allegedly threatened to deploy an electric taser and spray mace. The debtor further alleged that the same threats were directed at her son when he went outside the house as well. The debtor brought this complaint against the towing service, and the towing service moved for a judgment on the pleadings under Federal Rule of Civil Procedure 12(c).

In GERBASI v. NU ERA TOWING & SERV., 443 F. Supp. 3d 411 (W.D.N.Y. 2020), the court refused to dismiss the debtor's case on the pleadings because the debtor adequately alleged violations of the Fair Debt Collection Practices Act (FDCPA) against the towing service. The towing service first argued that documentation created in the regular course of business showed that none of its employees visited the debtor's property on the date of the alleged violation. However, the court held that this evidence created a factual dispute with the debtor's allegations. Such a dispute, the court held, is not appropriately resolved by a judgment on the pleadings. The towing service also argued that, assuming the truth of the allegations, it still did not violate the FDCPA because it had a "present right to possession of the property via an enforceable security interest." Such a right to possessionturns on the Uniform Commercial Code (UCC), which states that a secured party -- here, the towing service-- may take possession of the collateral -- here, the debtor's car -- without judicial process if it proceeds without any breach of the peace. If the peace is breached, legal process is required. New York case law defines a breach of the peace as a "disturbance of public order by an act of violence, or by any act likely to produce violence, or which by causing consternation and alarm, disturbs the peace and quiet of the community." The court concluded that the debtor had adequately pied a breach of the peace based on her allegations that the towing service trespassed on her property and threatened physical harm to both her and her son. Therefore, the court denied the towing service's motion for judgment on the pleadings because the debtor appropriately alleged the towing service's breach of the peace. *[By Will Watson will.watson@ttu.edu]*

SUBCHAPTER V

PPP Loan and Lease Rejection Claims Were Unliquidated On Petition Date So Debtor was Eligible for Subchapter V [BKR D MD]

A debtor who owned leases for parking facilities filed for subchapter V relief under chapter 11 of the bankruptcy code. Subchapter V is a new subchapter of chapter 11, designed to be less expensive than a traditional chapter 11 case and more streamlined. To be eligible for subchapter V as of the debtor's petition date, a debtor had to have not more than $7.5 million in noncontingent, liquidated secured and unsecured debts.

On the petition date, the debtor sought authority to reject a dozen leases. The court approved the rejections, which were to become effective after the petition date. In addition, before the bankruptcy petition, the debtor had obtained a Paycheck Protection Program ("PPP") loan created by the 2020 Coronavirus Aid, Relief and Economic Stimulus Act. The debtor filed schedules with priority unsecured claims and unsecured claims, an unknown claim for an ongoing litigation, and a contingent claim for the PPP loan. A representative of the claimant holding the unliquidated litigation claim objected to the debtor's designation under Subchapter V on the theory that its claim, if correctly listed on the schedules, would render the debtor above the Subchapter V $7.5 million limit. The court held hearings on whether the debtor was eligible to be a debtor under subchapter V of chapter 11 of the Bankruptcy Code.

In IN RE PARKING MGMT., 620 B.R. 544 (Bankr. D. Md. 2020), the court determined that the debtor was eligible to proceed under Subchapter V. The court examined the debtor's schedules, proofs of claim, and other evidence offered to decide whether the debtor's liquidated and noncontingent debts exceeded the statutory limit of $7.5 million. In so doing, the court was guided by case law under chapters 12 and 13 of the bankruptcy code, which also have filing limits. The bankruptcy court determined that the 11 U.S.C. § 1182 language required debts to be calculated as of the filing of the bankruptcy petition. Because the leases were not rejected until after the petition was filed, those claims arising from lease rejection were contingent on the petition date. Similarly, the claim related to the dispute with the creditor was unliquidated as of the petition date.

The court then evaluated the nature of the PPP loan and whether the liability on the PPP was contingent on a future

event that may never occur. The PPP loan rules provided for debt forgiveness if the debtor used the loan in accordance with the statute's requirements. As of the petition date, the petitioner had met the requirements to receive the PPP loan forgiveness. The court concluded that the PPP loan was a loan that could ultimately be forgiven. The court explained that the concept of "liquidated" debt relates to amount of ultimately realized liability and not existing liability. In doing so, the court found in favor of the debtor and did not include the PPP loan or the pre petition leases in the debt limit calculation for Subchapter V. Accordingly, the debtor was eligible for subchapter V of chapter 11. *[By Jimmy D. Vaughn jimmy.d.vaugh@ttu.edu Ed. Melissa Clark]*

Tracy Kennedy

Role of NDBA General Counsel

NDBA's general counsel serves as the attorney for the association. Although Tracy is pleased to be able to serve as a resource for NDBA members in responding to their questions, she is providing general information, not legal advice. Banks must obtain legal advice from counsel who has been retained by the bank to represent the bank's interests in a specific matter.

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