Home Sweet… Uh-Oh: Owners, Obligors, Options and Obstacles

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Modification of Mortgages Post-Chapter 7 Discharge

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Prior to the onset of the 2008 financial crisis, consumer debtors in the First Circuit who were contemplating bankruptcy and hoping to retain homes encumbered by mortgage loans had two choices: they could (1) file a chapter 7 bankruptcy petition and reaffirm the mortgage debt; or (2) file a chapter 13 bankruptcy petition, in connection with which they would be required to pay this entire arrearage during the pendency of a three or give year plan. Now, with the advent of the Home Affordable Modification Program ("HAMP"), debtors are frequently seeking modifications of their mortgage loans —— regardless of which form of bankruptcy protection they seek. With even greater frequency, debtors are attempting to modify their home mortgages after receiving their chapter 7 discharge without first executing a reaffirmation agreement. In short, debtors seek to enjoy the benefits of the discharge without incurring the personal liabilities associated with reaffirmation.

This article investigates whether debtors in a Chapter 7 Bankruptcy in the First Circuit can modify their mortgages (i) after receiving a chapter 7 discharge, and (ii) but without a reaffirmation agreement.

I. INTRODUCTION

A. 11 U.S.C. § 521- The Debtor's Statement of Intention

Section 521(a)(2)[1] of the Bankruptcy Code provides that an individual Chapter 7 debtor whose "schedule of assets and liabilities includes debts which are secured by property of the estate…[shall] 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 as exempt, that the debtor intends to redeem such property, or that the debtor intends to reaffirm debts secured by such property…"[2] The Statement of Intention must be filed "within thirty days after the date of the filing of a petition under chapter 7 of this title or on 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…" Then "within forty-five days after the filing of a notice of intent under this section, or within such additional time as the court, for cause, within such forty-five day period fixes, the debtor shall perform his intention with respect to such property…."

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[1] [I]f 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 filing of a petition under Chapter 7 of this title or on 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 as 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 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).

[2] *See* Lawrence P. King, *Collier on Bankruptcy* P521.10[2] (15th rev. ed. 1999) ("By its own terms, section 521(a)(2) does not apply in any other chapter."; *see also* Fed. R. Bankr. P. 1007(b)(2).

Prior to the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA"), a split existed among the Circuits as to whether a Chapter 7 debtor could retain collateral and make payments without redeeming or reaffirming the debt. Several Circuits held that debtors could retain secured collateral without reaffirming the debt, by exercising the so-called "ride-through option." *In re Price,* 370 F.3d 362, 379 (3d Cir. 2004); *McClellan Federal Credit Union v. Parker (In re Parker),* 139 F.3d 668, 673 (9th Cir. 1998); *Lowry Federal Credit Union v. West (In re West),* 882 F.2d 1543, 1547 (10th Cir. 1989). Other Circuits squarely rejected the ride-through option and held that the "plain language" of Bankruptcy Code Section 521(2) "does not permit a Chapter 7 debtor to retain the collateral property without either redeeming the property or reaffirming the debt." *See Bank of Boston v. Burr (In re Burr),* 160 F.3d 843, 845 (1st Cir. 1998); *Taylor v. AGE Federal Credit Union (In re Taylor),* 3 F.3d 1512, 1517 (11th Cir. 1993); *In re Edwards,* 901 F.2d 1383 (7th Cir. 1990); *In re Bell,* 700 F.2d 1053, 1056-1058 (6th Cir. 1983).

In *Burr,* the First Circuit Court of Appeals rejected the existence of the ride-through option and held that § 521(2) unambiguously requires chapter 7 debtors wishing to retain property secured by property of the estate to elect one of the retention options specified in §521(2)(A) and to perform the elected option within the time proscribed by § 521(2)(B).[3] 160 F.3d at 849; *see also Bank Boston, N.A. v. Claflin (In re Caflin),* 249 B.R. 840, 844 (B.A.P. 1st Cir. 2000). Thus before BAPCPA, the law in the First Circuit clearly prohibited the ride-through option.

Again, the Circuits are split as to whether BAPCPA allows the debtor can retain collateral and make payments without redeeming or reaffirming the debt. Debtors typically argue that by expressly prohibiting the ride-through option for *personal* property, Congress implicitly codified the ride-through option for real property. In support of this notion, debtors rely upon an assortment of cases from various jurisdictions. *See In re Carabello,* 386 B.R. 398 (Bankr. D. Conn. 2008); *In re Waller,* 94 B.R. 111 (Bankr. D.S.C. 2008); *In re Wilson,* 372 B.R. 816 (Bankr. D.S.C. 2007); *In re Bennet,* 2006 WL 1540842 (Bankr. M.D.N.C. May 26, 2006). In *Carabello,* the court held that "when Congress eliminated the ride through option for personal property in BAPCPA, Congress was aware that there was a ride through option for real property and intended to leave it intact post-BAPCPA." 386 B.R. at 702. However, *Carabello* and the other cases relied upon by debtors are all in Circuits that permitted the ride-through option for real and personal property before BAPCPA's enactment. In fact, in its reasoning, the *Carabello* court stated that its conclusion was based on the pre-existing landscape in the Second Circuit, which had held that the ride-through option applied to both real and personal property. *Id. See Capital Communications Federal Credit Union v. Boodrow (In re Boodrow),* 126 F.3d 43 (2d Cir. 1997); *BankBoston, N.A. v. Sokolowski (In re Sokolowski),* 205 F.3d 532 (2d Cir. 2000)).

The First Circuit's caselaw prior BAPCPA rejected the existence of a ride-through option for any type of property. *See Burr,* F.3d at 849 ("[W]e believe that 11 U.S.C. § 521(2) unambiguously requires chapter 7 debtors wishing to retain property of the estate…to elect one

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[3] In *Burr,* the Court was interpreting § 521(2)(A) and (B). Under BAPCPA these sections were changed to § 521(a)(2)(A) and (B).

of the retention options specified in 11 U.S.C. § 521(2)(B)"). The Eleventh Circuit, like the First Circuit, pre-BAPCPA also rejected the ride-through option. *See Taylor v. AGE Federal Credit Union (In re Taylor),* 3 F.3d 1512, 1517 (11th Cir. 1993).

More recently, a District Court in the Eleventh Circuit had the opportunity to explore this issue post-BAPCPA. The District Court in *In re Linderman,* 435 B.R. 715 (Bankr. M.D. Fla. 2009) held that the ride-through option does not exist for real property after BAPCPA. In *Linderman,* the debtor was current on the mortgage payments and indicated on the statement of intention that the Debtor intended to retain the home and continue making monthly regular payments. 435 B.R. at 715. The mortgagee objected, stating the debtor may only keep the home only if he had either redeemed or reaffirmed the debt. *Id.* at 716 (citing *Taylor v. AGE Federal Credit Union (In re Taylor),* 3 F.3d 1512, 1517 (11th Cir. 1993)). As a part of BAPCPA, § 521(2)(A) was re-designated as § 521(a)(2)(A), but its language remained otherwise unchanged. *Linderman,* 435 B.R. at 716.

Congress, however, added several provisions in BAPCPA that clearly removed the ride-through option as to personal property. The *Linderman* court was faced with the issue of how these amendments affect the ride-through option regarding real property. *Id. a*t 717. "BAPCPA essentially is silent as to whether a debtor is required to either reaffirm or redeem real property." *Id.* The court concluded that "[t]he modification enacted by BAPCPA simply supports the Eleventh Circuit's conclusion as to personal property." *Id.* At 718. Thus, the court held that the reasoning of *Taylor* similarly prohibiting the ride-through option for real property "is still applicable and controlling until the Eleventh Circuit rules otherwise." *Id.*

Accordingly, based upon the First Circuit's decision in *Burr,* and absent any other authority to the contrary in the First Circuit Bankruptcy Court or otherwise if a Debtor intends to keep his or her home in a chapter 7 Bankruptcy case, the debtor should be prepared to either redeem or reaffirm. Simply put, seeking a modification of the mortgage debt by HAMP or otherwise appears not to be permitted without the debtor first having availed herself of both the benefits and burdens of a reaffirmation agreement.

B. Remedies Available to Creditors and Servicers for the Debtor's Failure to Comply with 11 U.S.C. § 521(2)(B)

Congress provided no express mechanism for enforcing § 521(2) except for the Chapter 7 Trustee's duty to ensure performance. *See in Manderson,* 121 B.R. 617, 620-621 (Bankr. N.D. Ala. 1990); *In re Irvine,* 192 B.R. 920, 921 (Bankr. N.D. Ill. 1996) ("There is no statutory sanction for failure to comply with Sections 521(2)(A) and (B)."). The Bankruptcy Courts have yet to craft any practice, the remedies they order are inevitably tied to the individual facts of each case. *See Am. Nat'l Bank & Trust Co. v. DeJournette,* 225 B.R. 86, 97 (W.D. Va. 1998) ("The proper resolution seems to be a matter of discretion based on the facts of a given case."). "In the absence of a specific statutory remedy for a debtor's failure to perform his or her intentions under § 521(2)(B), the courts have fashioned remedies or sanctions under several provisions of the Bankruptcy Code." *In re Donnell,* 234 B.R. 567, 572 (Bankr. D.N.H. 1999). These remedies include:

1. Compelling the debtor to comply with § 521(2)(B), pursuant to the Court's powers under § 105(a);

2. Dismissing the case pursuant to § 707(a);

3. Declaring the relevant debt non-dischargeable, pursuant to § 523(a); or

4. Granting relief from the automatic stay pursuant to § 362.

Id.

II. THE HOME AFFORDABLE MODIFICATION PROGRAM

A. The HAMP Directive

Despite the split in the Circuits regarding the ride-through option, the United States Department of the Treasury explained in a supplemental directive that a modification for a debtor who did not reaffirm mortgage debt may nevertheless be allowed under HAMP:

> Borrowers who have received a Chapter 7 bankruptcy discharge in a case involving the first lien mortgage who did not reaffirm the mortgage debt under applicable law are eligible for HAMP. The following language must be inserted in Section 1 of the Home Affordable Modification Agreement: "I was discharged in a Chapter 7 bankruptcy proceeding subsequent to the execution of the Loan Documents. Based on this representation, Lender agrees that I will not have personal liability on the debt pursuant to this Agreement.[4]

Since the advent of HAMP, only been a handful of courts have determined whether lenders must offer modifications to discharged debtors in chapter 7 proceedings. *See In re Tincher,* 2011 Bankr. LEXIS 2515, at *3 (Bankr. D.S.C. July 5, 2011) ("This directive makes clear that debtors who file bankruptcy were intended to be eligible for HAMP post-bankruptcy, without being required to reaffirm their mortgage debt."); *In re Bellano,*465 B.R. 220 (Bankr. E.D. Pa. 2011); *In re Pope,* 2011 Bankr. LEXIS 655 (Bankr. E.D. Va. 2011) (not decided pursuant to HAMP, but rather pursuant to a modification of the mortgage loan based upon the existence of the ride-through option); *Reynolds Living Trust v. Wells Fargo Bank, N.A. (In re Reynolds),* 2011 Bankr. LEXIS 3352 (Bankr. W.D. Va. 2011) (holding that despite the Debtor's discharge the debtor could still pursue a modification under HAMP). However, in each of these jurisdictions, the ride-through option was already available.

[4] Supplemental Directive 10-02, Home Affordable Modification Program-Borrower Outreach Communication, at 8, available at https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/sd1002.pdf (March 24, 2010).

While not squarely on point, the Massachusetts Superior Court in Barnstable ruled as follows on a Creditor's Motion to Dismiss:

> Additionally, Plaintiff failed to enter a voluntary reaffirmation agreement with BAC regarding her mortgage debt. *See* 11 U.S.C. § 524(c) (allowing a Chapter 7 debtor to reaffirm a pre-petition debt, otherwise dischargeable in bankruptcy, by agreeing to pay all or part of that debt). ***Absent reaffirmation, Plaintiff cannot continue to make pre-discharge contractual payments. Unscheduled claims made on the basis of that debt cannot survive a Chapter 7 discharge***. She is therefore estopped from bringing pre-petition claims after Chapter 7 proceedings have granted her the "fresh start" that is the "overriding goal of the bankruptcy code." *See Reynolds Bros., Inc. v. Texaco, Inc.,* 420 Mass. 115, 123 (1995).

Conrad v. Federal Loan Mortgage Corp., 29 Mass. L. Rep. 603 at * 6 (2012) (emphasis added). The court also found that, since there is no private right of action under HAMP, the debtor could not sue on the basis of the lender's alleged failure to consider her for a mortgage modification. *Id.* (citing *Alpino v. JP Morgan Chase Bank, N.A.,* 2011 U.S. Dist. LEXIS 43210 at * 7 (D. Mass. 2011).

III. THE BANKRUPTCY DISCHARGE AND REAFFIRMATION AGREEMENTS

A. The Bankruptcy Discharge

A Chapter 7 discharge operates to discharge debtors "from all debts that arose before the date of the order for relief [date of the filing of the Chapter 7 Bankruptcy Petition]." § 727(b). The discharge continues to operate "as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor." § 524(a)(2).

> Discharge carries with it an injunction against debt collection efforts. The injunction imposed by Code § 524(a)(2) is intentionally broad in scope and is intended to preclude virtually all actions by a creditor to collect personally from the debtor. The House and Senate Reports made clear this intention:
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> > The junction is to give complete effect to the discharge and to eliminate any doubt concerning the effect of the discharge as a total prohibition on debt collection efforts. This paragraph has been expanded over a comparable provision in [the] Bankruptcy Act…to cover any act to collect such as dunning by telephone or letter, or indirectly through friends, relatives, or employers, harassment, threats of repossession, and the like. The change is…intended to ensure that once a debt is discharged, the debtor will not be pressured in any way to repay it.

Pratt v. GMAC, 341 B.R. 1, 3-4 (Bankr. D.M.E. 2005) (quoting 3 William L. Norton, Jr., Norton Bankruptcy Law and Practice 2d § 48:3, at 48-7 (1997) (footnote deleted)); *see Bessette v. Avco Fin. Servs., Inc.,* 230 F.3d 439, 444 (1st Cir. 2000) ("Generally, a discharge in bankruptcy relieves a debtor from all pre-petition debt, and § 524(a) permanently enjoins creditor actions to collect discharged debt.").

The Bankruptcy Court can invoke § 105(a)[5] to enforce § 524(a)'s discharge injunction. *Bessette,* 230 F.3d at 445. Redress can take the form of damages, attorney fees, and in really egregious situations punitive damages. *Id.*

B. Lien Enforcement in Bankruptcy

Creditors who hold a valid lien that is not avoided in a Chapter 7 Bankruptcy case are free to enforce those liens against their collateral even after the debtor's personal liability has been discharged. Liens that are not invalidated or avoided survive the debtor's discharge. *Pratt v. GMAC (In re Pratt),* 324 B.R. 1, 3-4 (Bankr. D. Me. 2005) (quoting 3 William L. Norton, Jr., Norton Bankruptcy Law and Practice 2d § 48:4, at 48-1 (1997). Sections 524(a)(1) and 524(a)(2) specifically enjoin only activities seeking to enforce a debtor's personal liability. *Id.* As a result, a post discharge action to "enforce a lien is an in rem action." *Id.* "It must proceed without recourse against the debtor for any deficiency." *Id.*; *see Arruda v. Sears, Roebuck & Co.,* 310 F.3d 13, 22 (1st Cir. 2002) ("Thus, the lienholder's right to repossess [or foreclose] is nothing more than a right to an equitable remedy for the debtor's default. The fact that this surviving right is *in rem* only limits the recourse that the lienholder can take to repossession or obtaining an amount of money reflecting the value of the collateral.") (citation omitted).

> Creditors holding valid liens that have "passed through" bankruptcy generally run afoul of the discharge injunction only if they enforce them in ways meant to coerce a debtor's payment of a discharged personal obligation. This occurs most often when the creditor threatens to repossess collateral that the debtor wants or needs to retain, but, without obtaining a property reaffirmation agreement, promises to forbear so long as the debtor continues making payments (which encompass the discharged personal liability):
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> > Prior to adoption of the Code, many debtors in liquidation cases were in fact denied the benefits of discharge due to threatened repossession of property by secured creditors who use the leverage of their liens to collect the prior debt. Congress found these creditor actions to be contrary to bankruptcy policy. The obvious intention of the Code is to eliminate the problem by expanding the terms of the discharge injunction, providing a statutory right to

[5] 11 U.S.C. § 105(a) provides as follows:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a part in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

> redeem property from a lien, and providing substantive and procedural restrictions on reaffirmation agreements. Nevertheless, circumstances may raise in which a debtor exempts property subject to a lien but is unable to redeem the property with cash or a reaffirmation agreement. In such circumstances, a creditor may attempt to use the threat of foreclosure as leverage to obtain repayment by the debtor. As in the case of conditional refusals to perform, while repossession does not violate § 524(a), the conditional threat is an act designed to collect the debt as a personal liability.

Pratt, 341 B.R. at 6-7 (quoting 3 William L. Norton, Jr., Norton Bankruptcy Law and Practice 2d § 48:4, at 48-12,-13 (1997) (footnotes omitted).

With this in mind, a debtor's execution of a modification agreement, by which agrees to make payments outside of bankruptcy, appears on its face, to run contrary to both the bankruptcy code. Moreover, it subjects the bank or loan servicer to an increased risk in the future of violation of the discharge injunction when and if the debtor fails to make payments. What happens when the servicer or lender sends a letter notifying the debtor that he in arrears and that absent payment, the servicer or lender intends to foreclose? Might such a notice be considered by the bankruptcy courts as a device "to coerce a debtor's payment of a discharged personal obligation?" Finally, if mortgage loans and loans secured by personal property can readily be modified and payments reduced without reaffirmation, there is really no incentive for a debtor to reaffirm at all and that would render the debtor's Statement of Intention unnecessary and inconsequential.

C. The Purpose of Reaffirmation Agreements

In cases involving mortgages, to avoid running afoul of the discharge injunction, creditors and debtors will typically execute a reaffirmation agreement. A reaffirmation agreement is a consensual agreement between a debtor and a creditor in which either party is free to negotiate terms in addition to those contained in the debt obligation being reaffirmed. *See Jamo v. Katahdin Fed. Credit Union (In re Jamp),* 283 F.3d 392, 400-401 (1st Cir. 2002). "Due to the importance of the [Bankruptcy] Code's 'fresh start' policy, . . . reaffirmation agreements are subjected to very stringent controls whose purpose is to ensure that debtors are neither coerced nor harassed by secured creditors into reassuming debts which would otherwise be entitled to discharge." *Pratt,* 462 F.3d at 18.

BAPCPA amended the provisions of § 524 with respect to reaffirmation agreements for consumer debts in cases filed on or after October 17, 2005. In order for the reaffirmation agreement to be enforceable, it must have been entered into **before** the granting of a discharge to the Debtor under § 727, and the disclosures required under § 524(k) must have been made at or before the time the debtor signed the agreement. § 524(c). In addition, the Bankruptcy Code requires both that (i) any reaffirmation agreement be filed with the court, and (ii) that the court determine after a hearing at which the debtor appears, that the reaffirmation agreement does not impose an undue hardship on the debtor. §§ 524(c) and (d).

Each jurisdiction has its own local rules that a practitioner should consult prior to the initiating a reaffirmation agreement with the debtor. The reaffirmation agreement must also advise the debtor of his or her right to rescind the reaffirmation agreement at any time (i) before the court enters a discharge order, or (ii) before the expiration of the 60-day period that begins on the date the reaffirmation agreement is filed with the court whichever occurs later. *See* Bankr. R. Civ. P. 4008.

IV. OPTIONS FOR THE DISCHARGED DEBTOR IN THE FIRST CIRCUIT

With the onset of the financial crisis of 2008 and plummeting property values, more servicers and lenders are waiting months (and sometimes years) before foreclosing on the mortgage. An ongoing issue for both debtors and their attorneys is what can be done when the creditor or servicer simply refuses to immediately foreclose. Another issue facing debtors' attorneys is what happens when lenders or servicers refuse to negotiate modification terms for home mortgages months or years after the chapter 7 discharge was granted on the basis that a reaffirmation agreement was not executed during the pendency of the debtor's bankruptcy case. What are the options available to counsel to assist their clients?

A. Reopening the Bankruptcy Case

Bankruptcy Rule 5010 provides that "[a] case may be reopened on motion of…[a] party in interest pursuant to § 350(b) of the Code." Section 350 governs the closing and reopening of bankruptcy cases. This section states as follows:

> (a) After an estate is fully administered and the court has discharged the trustee, the court shall close the case.
>
> (b) A case may be reopened in the court in which such case was closed to administer assets, to accord relief to the debtor, or for other cause.

"It is well settled that the decision to reopen a case is within the sound discretion of the bankruptcy court." *Massachusetts Dep't of Revenue v. Crocker (In re Crocker),* 362 B.R. 49, 53 (B.A.P. 1st Cir. 2007) (citing *In re McGuire,* 299 B.R. 53, 55 (Bankr. D.R.I. 2003) (citations omitted)). "This discretion depends upon the circumstances of the individual case and accords with the equitable nature of all bankruptcy proceedings." *Id.* (citations omitted).

In cases where no additional assets need to be administered, the bankruptcy case can only be reopened if it is necessary to accord the debtor additional relief or for other "cause." § 350(b). The moving party has the burden of demonstrating "cause" to reopen the case. *In re Otto,* 311 B.R. 43, 47 (Bankr. E.D. Pa. 2004); *In re Carter,* 38 B.R. 636, 638 (Bankr. D. Conn. 1984). While the Bankruptcy Code does not define "other cause" for purposes of § 350, bankruptcy courts generally will consider a variety of factors in determining whether to reopen a bankruptcy case including:

- the length of time the case was closed

- whether a non-bankruptcy forum, such as the state court, has the ability to determine the issue sought to be posed by the debtor;

- whether prior litigation in bankruptcy court implicitly determined that the state court would be appropriate forum to determine the rights, post-bankruptcy, of the parties;

- whether any parties would be prejudiced were the case reopened or not reopened; and

- whether it is clear at the outset that the debtor would not be entitled to any relief after the case were reopened.

In re Otto, 311 B.R. at 47 (citations omitted).

Here, a strong argument can be made that reopening the bankruptcy case would be beneficial to both the debtor and the servicer/creditor. For example, in the event that a modification program were offered to the debtor that had not previously been made available during the pendency of the original bankruptcy case, the argument could be made that a modification agreement entered into post-discharge would assist the debtor in keeping his or her home while simultaneously stopping another foreclosure. This theory does not appear to have been tested, at least in any reported decision, in the First Circuit.

B. Vacating the Discharge

The Bankruptcy Court has the power to vacate an order for "any…reason justifying relief from the operation of judgment." Fed. R. Civ. P. 60(b)(6) made applicable by Fed. R. Bankr. P. 9024. The United States Supreme Court has interpreted this rule liberally to allow the vacating or an order when "appropriate to accomplish justice." *Klapprott v. United States,* 335 U.S. 601, 614-615 (1948). Courts routinely employ this rule to vacate discharge orders for the purposes of allowing Chapter 7 debtors to enter into enforceable reaffirmation agreements under appropriate circumstances. *See In re Edwards,* 236 B.R. 124, 126 (Bankr. D.N.H. 1999); *In re Long,* 22 B.R. 152, 154 (Bankr. D. Me. 1982); *In re Solomon,* 15 B.R. 105, 106 (Bankr. E.D. Pa. 1981).

Despite this, Courts have cautioned that Fed. R. Civ. P. 60 should be used "sparingly" to allow reaffirmation agreements to be entered into post-discharge. *See e.g., In re Edwards,* 236 B.R. 124, 126 (Bankr. D.N.H. 1999) (requiring special circumstances to be shown); *Long,* 22 B.R. at 154 ("This court, however, does not intend to routinely grant [orders vacating discharge]."); *In re Eccleston,* 70 B.R. 210, 213 (Bankr. N.D.N.Y. 1986) (requiring "extraordinary circumstances").

It remains uncertain how a bankruptcy court would rule on this issue, but given the HAMP directive and the ability for the debtor to modify the note and mortgage, it would stand to reason that bankruptcy judges in the First Circuit may be receptive to this notion.

V. CONCLUSION

No court in the First Circuit has issued an opinion on whether modifications of mortgages post-chapter 7 discharge are allowed. As a result, creditors may justifiably refuse to modify mortgages absent the execution of a reaffirmation agreement. The risks associated with allowing the debtor to simply ride through without a reaffirmation agreement are much too great and expose the creditor to potential liability. In the event debtors wish to modify their mortgages post-chapter 7 discharge, they should: (1) file a motion to reopen their bankruptcy case; and (2) file a motion to revoke the chapter 7 discharge. Upon approval, the debtor can file his reaffirmation agreement along with any modification agreement. This procedure serves two purposes. First, it safeguards the debtor because it is under the purview of the bankruptcy court. Second, it safeguards the creditor by allowing the creditor to foreclose on the mortgage and collect on any deficiency in the event the debtor defaults again.

THE EFFECT OF LIENSTRIPPING ON CO-DEBTORS AND OTHER OBLIGATED THIRD PARTIES

In this new world of tight credit, the lenders are looking to cushion the impact of future losses and part of that strategy is to look to third party obligors and guarantors to protect them when the principal files for bankruptcy protection, knowing that § 524(e) of the Code generally allows pursuit of obligated third parties when things go bad, and the "L" word appears in the primary obligor's bankruptcy filing.

> *§ 524(e) "Except as provided in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt."*
> *[(A)(3) specifically refers to community claims].*

Is that reliance well placed?

1. **GENERALLY SPEAKING**:

It appears that it is, with the understanding that pursuit of these third parties may push some of them into their own bankruptcy filing. The Court of Appeals for the Fifth Circuit verified this in *United States v. Stribling Flying Service, Inc.,* 734 F.2d 221, 222 (5th Cir.1984), when it declined to accept the position of the guarantors who argued that confirmation of a plan that modified the claim therefore cured the default on the previously accelerated debt such that the obligation of the guarantors was limited to the modified obligation confirmed in the plan. That Court stated:

> *"We therefore have little difficulty in affirming the determination of the district court that the obligation of the Kimballs as unconditional guarantors of the corporate obligation to pay its Small Business Administration loan in full, was not affected by confirmation of the reorganization plan by which the corporate debt was restructured and reduced, nor by the participation of the creditor United States Agency in the Chapter XI proceedings that resulted in such restructuring and reduction of the corporate debt."*

Discharge of a debt in bankruptcy does not protect the guarantor from pursuit by the creditor because the obligation of the guarantor remains "unchanged"-see *McNulty v. McDonald*, 631 F.Supp.2d 115 (USDC, D ME, 2009) citing the First Circuit decision in *F.D.I.C. v. Municipality of Ponce, 904 F.2d 740, 748 (1st Cir.1990).*

However, the creditor must be acting in good faith against a true joint obligor and not attempting to recover against the debtor on a discharged debt by suing another party. In re Lumb, 401 B.R.1 (B.A.P.1st Cir. 2009):

"Allegations in Chapter 7 debtor's complaint, regarding creditor's commencement of what was ultimately found by state court to be meritless lawsuit against his nondebtor-spouse to hold her liable for transaction in which she had absolutely no participation, after debtor was discharged of any personal liability in connection with that transaction, in apparent attempt to coerce debtor into paying debt to avoid stress caused by the $50,000 in attorney fees that his wife incurred in defending creditor's suit, were sufficient to state claim for violation of discharge injunction."

2. *CHAPTER 7* –LIENS PASS THROUGH BANKRUPTCY

There is no statutory provision providing for an automatic stay against a non-filing co-debtor in a bankruptcy filed under Chapter 7. Thus, there are no corresponding protections. Of course, a Chapter 7 debtor may choose to reaffirm the debt which does, in and of itself, provide protections to the non-filing co-debtor.

3. THE CREDITOR AND THE CO-DEBTOR STAY IN CHAPTER 12 AND 13 AND THE CLASSIFICATION OF CLAIMS

Broadly, the protection of co-debtors is set out in §1301 and §1201 which stays a creditor's collection efforts relative to *civil* actions involving *consumer debts* of the debtor upon which any *individual* is also liable with the debtor or that secured the debt. This stay applies only to non-debtors who are obligated along with the debtor on consumer debts and it does not alter the substantive rights of a creditor to collect its claim in full either after relief from the co-debtor stay, closing of the case or conversion of the case. Those protected include joint obligors, guarantors, co-signers and sureties.

The stay applies until the case is closed, dismissed or converted to a case under chapter 7 or 11 as set forth in § 1301(a)(2) with certain exceptions listed below. The creditor first has to determine if the co-debtor stay applies at all. Is the debt a consumer debt, is the co-debtor an individual and is the debt related to a civil matter.

There is some case law suggesting that if the debtor obtained a discharge of that obligation in a prior chapter 7 case, the co-debtor stay does not apply in a subsequent chapter 13 for the reason that the debtor cannot seek to protect the co-debtor from an obligation he has been freed from paying. *In re Quinn*, 60 B.R. 286 (Bankr.N.D.Ohio, 1986). .

If the debtor is stripping off a secured claim as wholly unsecured, what impact does that have on the co-debtor? If the plan proposes not to pay the full amount of the claim, relief may be obtained from the co-debtor stay for the amount not being treated in the plan in order to collect the amount not provided for in the plan. *In re Cockerham* 336 B.R. 592 (Bankr.S.D.GA, 2005).

A lien held by a mortgagee survives the debtor's bankruptcy with respect to a non-filing co-debtor in spite of the plan's cram down provision. *In re Harris*, 199 B.R. 434, 437 (Bkrtcy.D.N.H. 1996). The creditor argued that the debtor's non-filing co-debtor could not avoid the bargained for obligations imposed by the mortgage, the mortgage covenants, and the assignment of leases and rents, without becoming a debtor in bankruptcy simply by having the co-debtor file for bankruptcy. *Id.* at 438. The Court agreed. *Id.*

Just as with the filing debtor, a creditor may request relief from the stay pursuant to 11 U.S.C. § 1301(c). A creditor can argue that the stay should be lifted if the co-debtor received consideration for the debt, the Chapter 13 plan does not include payment of that debt or the creditors' interest would be irreparably harmed by the stay. The party opposing the relief sought in a motion for relief from stay has the burden of proof on all matters, by a preponderance by the evidence, other than the debtor's equity in the property. 11 U.S.C. § 362(g). *In re Skwozinski*, 2001 BNH 34; 2001 Bankr. LEXIS 1306, (Bkrtcy.D.N.H. 2001). The creditor may proceed against the co-debtor if the Chapter 13 case is dismissed or converted to Chapter 7.

If the creditor moves for co debtor stay relief when the plan fails to provide for full payment of the claim, the stay terminates by operation of law 20 days after the motion is filed unless there is an objection filed. If a plan is dismissed, total due may be collected from debtor/co-debtor.

A discussion of classification of claims, allowed under 11 U.S.C. § 1322(b), necessitates a brief discussion of 11 U.S.C. § 1325(b), one of the provisions governing confirmation of a Chapter 13 plan.

> (b)(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan-
>
> (A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
>
> (B) the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on that date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.

Some courts interpret § 1325(b)(1)(B) to require that all the debtor's projected disposable income (PDI) be paid to unsecured creditors under the plan, but does not address how that income is to be allocated. *In re Rivera*, BAP Nos. PR 12-066, PR 12-067, Bkrtcy No. 11-07492-EAG, 2013 BAP LEXIS 1456, *10 (BAP 1st Cir. April 5, 2013). The BAP agreed with this interpretation as evident from the plain language of the statute. *Id.* at *17. The BAP stated that § 1325(b)(1)(B) does not govern allocation of payments among various types of unsecured creditor, but it is § 1322(b)(1), which permits classification of unsecured claims, which governs the allocation issue.

Rivera proposed to pay almost the entire amount of his general unsecured pool to pay a co-debtor debt, the Trustee objected claiming unfair discrimination. *Id.* at *5. The BAP having found that § 1325(b)(1)(B) did not govern allocation of PDI, looked to 11 U.S.C. § 1322 (b)(1), which provides:

> …the plan may (1) designate a class or classes of unsecured claims, as provided in § 1122 of this title, but may not discriminate unfairly against any class so designated; however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims; …

There are some limitations on the ability to classify claims. *See Id.* at *20-21. The general rule is that a debtor "may separately classify a claim if it is substantially similar to other claims in the class, if it provides the same treatment for each claim in the class, and if it does not discriminate unfairly." *Id.* at *21. The "however," clause caused a bit on controversy ever since it was added to the Bankruptcy Code. It appears that some courts read it as an exception to the unfair discrimination requirement and others do not. The BAP found useful the test outlined in *In re Thompson*, 191 B.R. 967, 971-72 to determine whether unfair discrimination has occurred. The test requires an examination of the following: "(1) whether the claim truly is a co-debtor consumer claim, 11 U.S.C. § 101(8); (2) whether the co-debtor undertook the underlying liability for the debtor's benefit or vice-versa; and (3) whether the plan satisfies the other requirements for plan confirmation, particularly the good faith requirement under 11 U.S.C. § 1325(a)(3). Notably, the presence or absence of good faith permeates the analysis and permits separate classification in most circumstances absent evidence of bad faith." *Id.* at *29. It should be noted that the U.S. Bankruptcy Court for the District of New Hampshire came to a different conclusion in a 1995 decision, finding that the classifications made in that case, favoring treatment of co-signed consumer debt unfairly discriminated against other creditors. *See In re Battista*, 180 B.R. 355 (Bkrtcy.D.N.H. 1995).

Essentially, what debtors tend to do is to place a co-debtor claim in one classification and place other debts without a co-debtor in another classification and allocate a greater share of their projected disposable income to the class containing co-debtor debt. Practically speaking, a co-debtor is usually a relative or friend whose claim the debtor feels compelled to pay. Likely, the debt is going to be paid anyway or at least attempted, and, therefore, a policy behind allowing for discriminating in favor of these types of debt is to consider them in the feasibility of the plan as a whole. An additional policy consideration is what happens when the debtor is unable to pay the debt and the co-debtor then has this responsibility. They may be forced to declare bankruptcy. And still, creditors may pursue collection activities against a co-debtor who is not in bankruptcy for payment of the claim or a part thereof. So is the basis for exempting co-debtor consumer debts – undertaken for the debtor's benefit- from the unfair discrimination restrictions which apply to other types of debts. *Id.* at *30-31.

4. CHAPTER 20 CASES: LIENSTRIP PROHIBITED

The debtor in a chapter 13 case attempted to strip down a first mortgage on tenanted property. Her husband was not a debtor in the case but owned the property with the wife/debtor as tenants by the entirety. The husband had received a Chapter 7 discharge. The Court held that both co-owners had to be debtors in the same case and each had to be eligible for a chapter 13 discharge in order to accomplish the strip down. *In re Pierre, 468 B.R. 419* (Bankr.M.D. FLA, Orlando Div., 2012).

5. CONVERSION TO CHAPTER 7: Impact on cramdown

As a result of the 2005 amendments, § 348(f)(1)(B) and (C) mandates the lien of a secured creditor is revived when a case converts from a case under Chapter 13 to Chapter 7. The modified lien established under a Chapter 13 plan does not survive conversion and the lien remains unsatisfied unless the claim has been paid in full as determined by non-bankruptcy law. This is NOT applicable in cases that are converted from Chapters 11 or 12.

6. §524(e) vs §105(a)

What about the interplay between §524(e) vs §105(a)? Can a bankruptcy court approve a reorganization plan that contains injunctions protecting non-debtors from creditors, granting essentially a "discharge" to entities which have not filed for bankruptcy protection by utilizing the equitable provisions in §105(a)? Apparently in very limited instances it can--the Court of Appeals decision in the *Monarch Life* case (*Monarch Life Ins. Co. v. Ropes & Gray,* 65 F.3d 973 C.A.1 (Mass.),1995) wrestled with the interplay between the two sections:

> *"The more intricate "jurisdictional" question raised by the confirmation order and contempt proceedings in this case is whether Congress intended an outer temporal boundary on the availability of injunctive relief under Bankruptcy Code § 105(a). Since the chapter 11 debtor is the only entity permanently discharged upon confirmation of a chapter 11 plan, id. § 1141(d), its creditors usually are free to pursue all available remedies against those undischarged entities which were obligated, along with the chapter 11 debtor, on a prepetition debt. "[D]ischarge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt."). Whether the Code likewise empowers bankruptcy courts to enter permanent injunctions which effectively confer de facto "discharge" relief upon the chapter11 debtor's co-obligors, and if so, under what conditions and limitations, are the topics of continuing debate and disagreement in both case law and commentary."*

The Court affirmed the District Court 's decision that the failure of a creditor to object to provisions in a plan of reorganization once confirmed, that contained injunctions against subsequent legal action against non-debtors , was barred by res judicata. See also the case of *Mahoney Hawkes, LLP* 289 B.R. 285 (Bankr.D.Mass. 2002) and *M.J.H. Leasing, Inc*., 328 B.R. 363, 3 65(Bankr.D.Mass. 2005) The Court discussed plan provisions that contained third party releases and injunctions, pondering whether they were prohibited pursuant to Section 524(e), and agreed that under **very exceptional circumstances**, in accordance with the five factors set forth

by the Missouri Bankruptcy Court in the *Master Mtg.Inv.Fund.Inc* case, 168 B.R. 930, 935 Bank.W.D.Mo.1994) the plan could be confirmed despite the third party releases and injunctions. Those five factors are:

1. There is an identity of interest, usually an indemnity relationship, between the debtor and the third party being released such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate.

2. The non-debtor being released has contributed substantial assets to the reorganization.

3. The proposed injunction is essential to the reorganization and without it, there is little likelihood of success.

4. A substantial majority of the creditors agree to the injunction, specifically, the impacted classes have "overwhelmingly" voted to accept the proposed plan treatment.

5. The plan provides a mechanism for the payment of all, or substantially all, of the claims of the class or classes affected by the injunction.

Another case in this district, *In re Brian M. Adley*, 333 B.R. 587 (Bankr.D.Mass.2005) adopted the same factors set forth in *Master Mtg* and citing the case law in the First Circuit regarding the use of §105(a) that "This grant of equitable power is not unlimited" and that "…it is an extraordinary exercise of discretion to use that power to stay a third party action not involving the debtor." citing *In re G.S.F. Corp*., 938 F2d 1467 (1st Cir.1991)

More recently, this district addressed the matter in the 2011 decision *In re Quincy Medical Center, Inc. Slip Copy, 2011 WL 5592907 Bkrtcy.D.Mass.,2011* and agreed with the prior cases cited above citing the *Master Mtg*. five factors.See also *In re Chicago Investments, LLC* 470 B.R. 32 Bkrtcy.D.Mass.,2012.

7. ESTABLISHING DEBTOR NOMINAL LIABILITY TO REACH A THIRD PARTY

A discharge in bankruptcy issued pursuant to 11 U.S.C. § 727 "... operates as an injunction against the commencement or continuation of an action ... or any act, to collect, recover or offset any ... debt as a personal liability of the debtor ..." In re Ruebush citing 11 U.S.C. § 524(a)(2). However, rather than extinguishing the debt altogether, the discharge "... merely releases the debtor from personal liability for the debt," leaving the liability of any other entity on such debt unaffected. *In re Edgeworth*, 993 F.2d 51, 53 (5th Cir.1993) wherein the Court ruled that a discharge under § 524 does not prevent a suit to recover against a third party. The debt is not discharged in bankruptcy-only the debtor is discharged from personal liability on that debt. Other persons liable on that obligation are not immune from collection efforts. This case examined §524(a) as to whether it barred a suit against the debtor post-discharge when the suit was necessary only to establish the liability needed to pursue a collection against the insurer.

The Court ruled that such a "liability-fixing" suit was permissible so long as the debtor was not obligated to pay for the costs of the defense of the suit to establish liability. See also 11 U.S.C. 524(e).

524(E) allows a creditor to recover against another entity who may be liable on the debtor's behalf and courts almost unanimously allow creditors to proceed against the debtor for purposes of collecting from the debtor's liability insurer. *Perez v. Cumberland Farms, Inc.*, 213 B.R. 622, 623 (D.Mass. 1997). Although, courts allowing such claims do so on the condition that the debtor not be rendered personally liable in any way by any action by the Court, including costs and attorney's fees. *Id.* Perez was allowed to proceed against Cumberland Farms, after discharge of its debts, on a personal injury claim provided she gave assurances that there would be no negative economic consequences to the Debtor. *Id.* at 624. See also *In re Walker,* 927 F.2d 1138, 1142 (10th Cir.1991) ("*It is well established that this provision permits a creditor to bring or continue an action directly against the debtor for the purpose of establishing the debtor's liability when, as here, establishment of that liability is a prerequisite to recovery from another entity*.").

In a related issue, a creditor cannot, however, object to a co-debtor wife's Chapter 7 discharge when she was not, in fact, a debtor of that creditor, but can object to the co-debtor husband against whom she obtained a judgment. *In re Barry*, 451 B.R. 654 (1st Cir. BAP 2011). The United States Bankruptcy Appellate Panel for the First Circuit (BAP) reversed the judgment of the bankruptcy court denying the wife's discharge in bankruptcy based on actual intent, on the part of the debtors, to hinder and delay collection of the debt. *Id.* The court reversed the judgment based upon standing even though the debtor-wife did not raise her standing until the appeal. *Id.* at 660. "[A] defect in standing cannot be waived; it must be raised, either by the parties or by the court, whenever it becomes apparent." *Id.* (quoting *U.S. v. AVX Corp.*, 962 F.2d 108, 116 n.7 (1st Cir. 1992)). Finding no claim against the wife, and applying the general rule that "the filing of a joint petition does not, by itself, consolidate the estates and their concomitant liabilities, the BAP concluded that the bankruptcy court committed an error of law in denying the wife a discharge.

8. EFFECT OF DISMISSAL OF THE CASE

Creditors should be careful to monitor the bankruptcy case. As discussed above, once a case is dismissed pursuant to the automatic stay terminates immediately and a creditor is free to pursue state law remedies against the debtor and any lien voided under 506(d) is reinstated unless the court has for cause ordered otherwise and the dismissal is other than under §742. . *Lomagno v. Salomon Brothers Realty Corp. (In re Lomagno)*, 429 F.3d 16, 17 (1st Cir. 2005). The automatic stay does not survive the dismissal, even when the dismissal is appealed. *Id.* The Federal Rules of Bankruptcy Procedure provide that a debtor may seek a stay pending an appeal. *Id.*; Fed. R. Bankr. P. 8005. However, if the debtor fails to do so, as they did in *Lomagno*, then a creditor's initiation of a collection action does not violate the automatic stay. *Id.* *Cf. Great Pac. Money Mkts, Inc. v. Krueger (In re Krueger)*, 88 B.R. 238 (B.A.P. 9th Cir. 1988)(finding a violation of the automatic stay when the debtors when the debtors received no notice and were not present at the hearing).

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MASSACHUSETTS
WESTERN DIVISION

In re **Debtor**	**Chapter 7** **Case No. 11-_____-HJB**

TRUSTEE'S STIPULATED MOTION FOR AUTHORITY TO COMPROMISE CLAIMS IN DEBTOR'S ASSETS

NOW COMES Steven Weiss, Trustee ("Trustee") for the estate of _____(the "Debtor"), and hereby requests authority to compromise claims relating to voiding mortgages owned or serviced by Bank of America, N.A. ("BOA") due to allegedly defective property descriptions. In support thereof, the Trustee respectfully states as follows:

1. On _____, 2011, the Debtor filed a petition for relief under Chapter 7 of the Bankruptcy Code with this Court.

2. The Trustee was appointed and continues to serve as Trustee.

3. The Debtor resides at_____, Massachusetts (the "Property").

4. The Property consists of two parcels of land.

5. The first parcel of the Property contains the residence ("Residence"), which the Debtor acquired on November 1, 1996. The second parcel of the Property is an adjoining parcel (the "Side Lot") acquired by the Debtor on March 4, 1998.

6. In the Debtor's Schedule A, she values the Residence at $234,000.00 and the Side Lot at $1,000.00.

7. In the Debtor's Schedule D, she represents that the Residence is not subject to any mortgages, and that the Side Lot is subject to two mortgages, a first mortgage held (or serviced) by BOA in the amount of $62,313.00, and a second mortgage held (or serviced) by BOA in the amount of $49,000.00.

8. The _____County Registry of Deeds reveals that the Debtor granted a mortgage to Fleet Bank on May 7, 2004 as security for a $100,000 loan. Upon information and belief, Fleet and/or its successors merged with BOA. The _____ County Registry of Deeds also reflects that the Debtor granted a mortgage to BOA on December 20, 2005, as security for a $50,000 loan. Upon information and belief, BOA is the holder or servicer of the loans. The foregoing mortgages are collectively referred to as the "Mortgages."

9. The Mortgages do not have "metes and bounds" property descriptions attached to them. Instead, each of the Mortgages attaches a "Schedule A" which refers to the mortgaged property as "being more particularly described in a deed recorded in Book ____, page ___," i.e., the Debtor's Side Lot.

10. On November 22, 2011, the Trustee filed an adversary proceeding seeking a declaratory judgment and order avoiding mortgages held or serviced by BOA against property of the estate and to preserve the liens for the benefit of the bankruptcy estate (the "Adversary Proceeding").

11. In the Adversary Proceeding, the Trustee alleged that the Mortgages are defective as to the Residence and that they are therefore unperfected liens against the Residence. Therefore, the Trustee sought to avoid the Mortgages pursuant to 11 U.S.C. §544, with the liens

preserved for the estate under 11 U.S.C. §551. The Court has entered default judgment against Bank of America voiding the Mortgages and preserving the liens for the estate.

12. The Debtor has asserted defenses in the Adversary Proceeding, contending that if the Mortgages never existed, the Trustee cannot avoid them under 11 U.S.C. 544.

13. The Trustee has engaged in negotiations with the Debtor, regarding the Trustee's claims. As a result of those discussions, the parties have reached the following agreement, subject to approval by this Court: (A) the Debtor will execute a note payable to the Trustee for Seventy-Five Thousand and 00/100 ($75,000.00) Dollars payable over (10) ten years with interest for the first five (5) years at a fixed rate of five (5%) percent and the second five (5) years at an adjusted rate of two (2%) percent over prime (the "Note"); (2) the Debtor will grant the Trustee a first priority mortgage on the Residence (the "Mortgage") to secure payment of the Note; (3) upon receipt of the executed Note and Mortgage the Trustee shall execute a stipulation of dismissal of the Complaint against the Debtor in the adversary proceeding with prejudice and without costs; and (4) the Debtor shall not be entitled to any money from the bankruptcy estate for any property exemption. Drafts of the proposed Note and Mortgage are attached hereto collectively as Exhibit A.

14. While the Debtor will be obligated to commence making payments to the Trustee upon execution of the Note, it is the Trustee's intention to sell the Note and Mortgage (subject to Court approval).

15. This compromise governs only those assets that have been disclosed in the Debtor's petition and schedules, and does not compromise any other presently unknown claims against the Debtor, or against any other party not specifically described herein.

16. The Trustee believes this compromise is in the best interests of the estate for several reasons. The approximate aggregate value of the Mortgages is $112,000. Were the

Trustee to seek to sell the Residence, only, this is the maximum amount available for the estate. Moreover, the Debtor contends that the Mortgages never attached to the Residence, and that her homestead exemption has priority over the Trustee's claims. The settlement amount of $75,000 represents only a 33% discount in the value. As there is approximately $56,000 in timely filed unsecured claims, the settlement will yield a substantial dividend to unsecured creditors. Absent a settlement, the estate may incur substantial litigation expenses in this matter, as the claim is disputed by the Debtor.

17. In evaluating a settlement for the estate, a Bankruptcy Court should "assess and balance the value of the claim that is being compromised against the value to the estate of the acceptance of the compromise proposal." *Jeffrey v. Desmond*, 70 F.3d 183, 185, *quoting In re GHR Cos.*, 50 B.R. 931 (Bankr. D. Mass. 1985). A Trustee's judgment concerning the justifications for a settlement is ordinarily provided some deference. *Hill v. Burdick (In re Moorhead Corp.)*, 208 B.R. 87 (1st Cir. 1997).

18. The Trustee believes that this compromise satisfies these criteria, as the estate will be recovering approximately 67 percent of the value of the voided Mortgages.

WHEREFORE, for cause shown, and pursuant to Bankruptcy Rule 9019 the Trustee respectfully prays:

1. That this Court authorize the Trustee to enter into the forgoing compromise;

2. That the Trustee be authorized to execute documents reasonably necessary to complete this compromise; and

3. For such further relief as this Court deems just and proper.

Respectfully submitted this __th day of _____, 2012.

STEVEN WEISS, TRUSTEE

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U\A16\ABI 2013\Sample Motion

TRUSTEE'S LIEN AVOIDANCE POWERS AND CONSUMER DEBTORS

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The Bankruptcy Code provides Chapter 7 trustees with the ability to void unperfected liens, and to preserve those liens for the benefit of the estate. When successful, those efforts can provide a significant recovery for creditors. However, when there are voidable liens are on a debtor's residence, the trustee's lien avoidance powers have the potential to run into direct conflict with a debtor's desire to retain his or her home. Conversely, a debtor can, in some circumstances, become the beneficiary of the trustee's efforts.

The mortgage boom in the last decade resulted in sloppy practices, which in turn has fueled trustees' lien avoidance efforts. Some examples include: mortgages not executed by all of the owners of the property[1]; mortgages discharged in error[2]; mortgages simply not recorded[3]; mortgages with deficient property descriptions[4]; and mortgages against Massachusetts real estate recorded in the registry of deeds instead of the land court registry. In addition, there have been a host of cases challenging the validity of

[1] See Weiss v. Wells Fargo Bank (In re Alejandro), Docket No. 12-3008 , and Weiss v. Interbay Funding, LLC, (In re Mota), Docket No. 11-3073 (both cases in the Massachusetts Bankruptcy Court).
[2] See, e.g., *Lassman v. One West Bank, FSB (In re Swift)*, 458 B.R. 8, 2011 Bankr. LEXIS 3889 (Bankr. D.Mass. 2011); Weiss vs. Village Mortgage, Inc, (In re Rajpold), Docket No. 13-3019 (Massachusetts).
[3] See, e.g*., DeGiacomo v. Traverse (In re Traverse)*, 485 B.R. 815; 2013 Bankr. LEXIS 487 B.A.P. 1st Cir. 2013); Weiss v. Citizens Bank (In re McMordie), Docket No. 11-3013 (Massachusetts).
[4] See, e.g, Weiss v. Bank of America, N.A. (In re Cooney) Docket No. 11-3063, and Ostrander v. Sovereign Bank, Docket No. 13-3018 (Both Massachusetts).

notary clauses on mortgages. Trustees have avoided—or at least challenged—notaries with the following defects: notaries which omit the names of the person signing the mortgage[5]; notaries which fail to state the manner in which the notary identified the mortgagor[6]; notaries that have the wrong name of the mortgagor or otherwise mis-identify the mortgagor[7]; and notaries that omit the date on which the document was signed and notarized[8].

Counsel for debtors who own real estate should assume that trustees will review almost every mortgage recorded against their clients' real estate; thus, counsel should do the same. If there is a potentially defective mortgage, counsel can then advise debtors accordingly, and at least prevent unwelcome surprises.

Statutory Basis for Lien Avoidance

Section 544(a)(3) of the Bankruptcy Code grants strong-arm powers to the trustee to avoid certain liens as a hypothetical bona fide purchaser of real property as of the commencement of the bankruptcy case.[9] The trustee holds the real estate, not as the

[5] See, e.g., *Agin v. Mortg. Elec. Registration Sys., Inc. (In re Giroux)*, 2009 Bankr. LEXIS 3429 (Bankr. D. Mass. May 21, 2009) and *Agin v. Mortg. Elec. Registration Sys. (In re Bower)*, 2010 Bankr. LEXIS 3641 (Bankr. D. Mass. 2010) , and *Weiss v. GB Mortgage, et. als. (In re D'Alessandro)*, __ B.R. ___, 2013 Bankr. LEXIS 1357 (Bankr. D. Mass. 2013).

[6] See, e.g., *In re Dessources*, 430 B.R. 330, 2010 Bankr. Lexis 1708 (Bankr. D. Mass. 2010).

[7] See, e.g., *Degiacomo v. CitiMortgage, Inc. (In re Nistad)*, 2012 Bankr. LEXIS 367 (Bankr. D. Mass .2012), and Weiss v. Wells Fargo Mortgage, Inc., (In re Kelley), Docket No. 12-3013 (Massachusetts) (appeal pending).

[8] See, e.g., Ostrander v. Citimortgage, Inc. Docket No. 13-3005.

[9] 11 U.S.C. § 544

> (a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by –
> …

debtor held the real estate, but with the rights and powers of a bona fide purchaser who bought the real estate from the debtor.[10] The bankruptcy court must look to state law to determine property rights under § 544(a).[11] A bona fide purchaser has been defined in Massachusetts as "[o]ne who buys something for value without notice of another's claim to the property and *without actual or constructive notice* of any defects in or infirmities, claims, or equities against the seller's title…."[12] While Massachusetts law states that one cannot be a bona fide purchaser if he had actual notice,[13] under 11 U.S.C. § 544(a) the trustee takes as a bona fide purchaser regardless of any actual knowledge of the trustee.[14] However, the trustee is still subject to constructive notice under Massachusetts law.[15] A party is charged with having constructive notice as a matter of law if the instrument has been properly recorded.[16] Thus, the trustee takes the debtor's real estate on the date of the bankruptcy filing as a bona fide purchaser, subject to all of the properly recorded liens and encumbrances and subject to the debtor's exemption in any equity.

Under Massachusetts law, a defective notary can deprive a mortgage from providing notice to subsequent parties. Pursuant to Mass. Gen. Laws ch. 183, § 30, a deed or other instrument requires an acknowledgement by one or more grantor or the

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…
(3) A bona fide purchaser of real property, other than fixtures, from the debtor against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.

[10] *Gray v. Burke* (*In re Coletta Bros. of North Quincy, Inc.*), 172 B.R. 159, 162 (Bankr. D. Mass. 1994).
[11] *Butner v. United States*, 440 U.S. 48, 54 (1979); *Stern v. Continental Assurance Co.* (*In re Ryan)*, 80 B.R. 264, 266 (D. Mass. 1987), *aff'd* 851 F.2d 502 (1st Cir. 1988).
[12] *See Terrill v. Planning Bd. of Upton*, 71 Mass.App.Ct. 171, 175 n.10 (2008) (emphasis added).
[13] "A conveyance … shall not be valid as against any person, except the grantor or lessor, his heirs and devisees and persons having actual notice of it…." MASS. GEN. LAWS ch. 183, § 4 (2003).
[14] 11 U.S.C. § 544(a).
[15] *Gray*, 172 B.R. at 163.
[16] *See* i*d.*

attorney executing it; otherwise it may not be recorded. Mass. Gen. Laws ch. 183, § 29. An unrecorded deed is valid only against the grantor, his or her heirs and devisees, and persons having actual knowledge pursuant to Mass. Gen. Laws ch. 183, § 4. "When an instrument of defeasance, not being acknowledged is improvidently admitted to registration then the record does not operate as constructive notice of the conveyance." Allen v. Allen, 21 LCR 8, 28 (Mass. Land Ct. 2013) (citing Graves v. Graves, 72 Mass. 391, 392-93, 6 Gray 391 (1856) (internal quotations omitted)).

As a hypothetical bona fide purchaser, trustees take debtors' real estate on the date of the bankruptcy filing, subject to all of the *properly* recorded liens and encumbrances, but not subject to mortgages that should not have been recorded in the first instance because acknowledgement is materially defective. If a mortgage is defective, or was improvidently recorded, the Trustee as a hypothetical bona fide purchaser cannot be on constructive notice of it, and the Trustee is entitled to avoid the mortgage under 11 U.S.C.§ 544.

Once the lien is avoided, its priority is preserved for the benefit of the estate, ahead of any homestead declaration. See *In re Guido*, 344 B.R. 193, 200 (Bankr. D. Mass. 2006); *See also Lassman v. One West Bank, FSB (In re Swift*), 458 B.R. 8, 2011 Bankr. LEXIS 3889 (Bankr. D.Mass. 2011; and *DeGiacomo v. Traverse (In re Traverse)* 485 B.R. 815; 2013 Bankr. LEXIS 487 B.A.P. 1st Cir. 2013). In Massachusetts the homestead statute specifically provides that homestead rights are subordinated to mortgages.[17]

Can the Debtor Avoid unperfected Liens?

[17] M.G.L. ch. 188, §9.

The First Circuit has not rendered a decision as to whether a chapter 13 debtor can maintain an adversary proceeding under §544 of the Bankruptcy Code. As a starting point, the term "debtor in possession" is a term of art applicable to chapter 11 proceedings only. See 11 U.S.C. § 1101(1) and *Jackson v. Martlette, (In re Jackson),* 317 B.R. 573, 578 (Bankr. D. Mass. 2004) (J. Feeney). §1302 of the Bankruptcy Code appoints the standing trustee the power to act as the trustee in all chapter 13 proceedings unless the United States trustee appoints another person. Bankruptcy Code §1308 gives exclusive rights to the chapter 13 debtor as it pertains to the use, sale or lease of property under §363 of the Bankruptcy Code.[18] In addition, the legislative history from §1303 states that "the section does not imply that the debtor does not also possess other powers concurrently with the Trustee," such as a debtor has the power to sue and be sued.[19] §522 gives all debtors limited rights to void involuntary liens and recover property that the debtor could have exempted had the transfer not occurred[20]; however, this provision does not help a Chapter 13 debtor, as the mortgage is a voluntary transfer.

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[18] 11 U.S.C. § 1303 states: "Subject to any limitation on a trustee under this chapter, the debtor shall have, exclusive of the trustee, the rights and power of a trustee under sections 363(b), 363(d), 363(e), 363(f) and 363(l) of this title."

[19] The legislative section under the 1978 acts states: "Section 1303 of the House amendment specifies rights and powers that the debtor has exclusive of the trustees. The section does not imply that the debtor does not also possess other powers concurrently with the trustee. For example, although section 1323 is not specified in section 1303, certainly it is intended that the debtor has the power to sue and be sued."

[20] 11 U.S.C. § 522(g) & (h) state as follows:

> (g) Notwithstanding sections 550 and 551 of this title, the debtor may exempt under subsection (b) of this section property that the trustee recovers under section 510(c)(2), 542, 543, 550, 551, or 553 of this title, to the extent that the debtor could have exempted such property under subsection (b) of this section if such property had not been transferred, if –

In the context of §544, the majority view in other districts and circuits appears to be that a chapter 13 debtor does not have standing to file a complaint to avoid a mortgage or consensual lien. See *Lewis v. Mortg. Elect. Registration Syst. (In re Lewis)*, 2008 Bankr. LEXIS 5102 (Bankr. E.D. Mich. 2008); *Huskey v. Citimortgage, Inc. (In re Huskey)* 479 B.R. 827, 2012 Bankr. LEXIS 4853 (Bankr. E.D. Ark. 2012); but see In re Cohen, 305 B.R. 886 (B.A.P. 9th Cir. 2004). In *Hansen v. Hansen (In re Hansen)*, 332 B.R. 8 (B.A.P. 10th Cir. 2005), the bankruptcy appellate panel dismissed the debtors' §544 action to attempt to avoid the creditor's lien on their mobile home when the UCC lien had lapsed at the local county clerk's office on the basis that the debtors did not have standing, and therefore, the bankruptcy court lacked subject matter jurisdiction. Similarly, a bankruptcy court held that a chapter 13 debtor could not avoid a mistakenly released mortgage under §544(a)(3) as the debtor did not have standing as the original granting of the mortgage was voluntary. *Gilliam v. Bank of America Mortgage, L.L.C. (In re Gilliam),* 2004 Bankr. Lexis 1653 (Bankr. D. Kansas 2004).

How can the Trustee Realize Value for the Voided Lien?

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(1)(A) such transfer was not a voluntary transfer of such property by the debtor; and
(B) the debtor did conceal such property; or
(2) the debtor could have avoided such transfer under subsection (f)(1)(B) of this section

(h) The debtor may avoid a transfer of property of the debtor or recover a setoff to the extent that the debtor could have exempted such property under sub-section (g)(1) of this section if the trustee had avoided such transfer, if –

(1) such transfer is avoidable by the trustee under section 544, 545, 547, 548, 549, or 724(a) of this title or recoverable by the trustee section 553 of this title; and
(2) the trustee does not attempt to avoid such transfer.

For trustees, of course, avoiding the lien is only half the battle. It creates potential equity for the estate, but that value still has to be converted to cash. A trustee cannot simply "sell the lien", as the trustee does not hold either the mortgage or the underlying note. Even before the recent Massachusetts Supreme Judicial Court opinions requiring foreclosing mortgagees to hold rights under the note in order to foreclose[21], there was no market for the voided lien without the note. So how can a trustee realize value for the equity created by avoiding the lien?

One way, of course is for the trustee to sell the property, which is property of the estate. That's fine if the debtors are abandoning the property, but obviously problematic if the debtors wish to retain their residence. And since the debtor's homestead exemption is subordinate to the voided lien, a debtor has little ability to object to a sale.[22] In some rare circumstances debtors may have the financial resources to compensate the estate for the value of the equity, but absent that, debtors still in bankruptcy have little ability to obtain financing for this purpose. A third alternative (with Court approval), which has at least some success, is for the debtors to sign a new note in favor of the trustee, secured by a new mortgage on the property. The trustee can then either collect payments or—more likely—sell the note and mortgage to a third party, albeit at a discount. This allows debtors the opportunity to retain the property, maybe even with reduced monthly

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[21] See, e.g., *Eaton v. Fed. Nat'l Mortgage Ass'n*, 462 Mass. 569, 585 (2012).

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[22] See, for example, *DeGiacomo v. Traverse (In re Traverse)*, *supra*. The debtor challenged the trustee's rights to sell her residence to obtain value for a voided lien. The Bankruptcy Appellate Panel affirmed the bankruptcy court's grant of summary judgment for the trustee, holding that the trustee does not merely replace the mortgagee; instead, he or she has all the rights of the debtor to sell the property.

payments, while enabling the trustee to realize value from the voided lien position. (See sample motion included with materials).