

PUBLICATION

One Appellate Court's Message to Debtors: Do What You Say!

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Mortgage lenders received some good news from the Eleventh Circuit Court of Appeals last week! In *Failla v. Citibank, N.A.*, Case No. 15-15626 (11th Cir. Oct. 4, 2016), the Court affirmed a bankruptcy judge's order for a married couple to stop opposing the lender's efforts to foreclose on their home in Boca Raton, Florida. As will be discussed below, *Failla* essentially affirms the principle that a bankruptcy debtor (or any other litigant) cannot take inconsistent positions in different legal proceedings.

Background of *Failla*

In *Failla*, a husband and wife owned a home with a \$500,000 mortgage and filed Chapter 7 in 2011 to halt a judicial foreclosure in a Florida state court. During the bankruptcy case, they declared they would "surrender" the home to their mortgage lender, Citibank. After receiving their discharge and exiting bankruptcy, however, the couple continued to oppose Citibank's judicial foreclosure action.

Frustrated by the borrowers' delay tactics in state court, Citibank returned to bankruptcy court and reopened the couple's bankruptcy case for the purpose of asking the judge there to compel the couple to stop opposing foreclosure. Citibank argued that the couple's opposition to the foreclosure is improper because they had already committed to surrendering the home in their bankruptcy case. The bankruptcy judge agreed with Citibank and ordered the couple to stop opposing the state court foreclosure under threat of a revocation of their bankruptcy discharge.

The Court of Appeals Weighs In

The Eleventh Circuit Court of Appeals considered two issues on appeal: first, whether the United States Bankruptcy Code (the "Code") prevents a debtor from opposing a mortgage lender's foreclosure after having surrendered the property; and second, whether a bankruptcy judge can order a debtor to stop opposing a judicial foreclosure proceeding in state court. Significant for mortgage lenders and other secured creditors, the Court decided both issues in favor of Citibank.

The Court decided the first issue by interpreting Section 521(a) of the Code, which addresses a Chapter 7 bankruptcy debtor's obligation to file a statement indicating the debtor's intent to retain or surrender each property serving as collateral for a debt— often referred to as a "statement of intention." Having filed a statement of intention and declared they would surrender their home, the couple had a duty to follow through. And the couple's duty to surrender extended to both the bankruptcy trustee and Citibank.

Further, the Court determined "surrender" means more than delivering physical possession of the home. In the context of the Code, "surrender" means a bankruptcy debtor is giving up any rights in the property at issue. Therefore, the Court concluded that the couple in *Failla* could not oppose Citibank's foreclosure action after having surrendered their rights in the home during their bankruptcy case. Plainly stated, the Court said "[d]ebtors who surrender property must get out of the creditor's way."

On the second issue, the Court rejected the couple's argument that the bankruptcy court's authority is limited to granting stay relief, so that in this particular case Citibank could continue with its state court foreclosure

action. Noting that the couple had already exited bankruptcy and the automatic stay was no longer in effect anyway, the Court reaffirmed that bankruptcy judges have broad remedial powers, including the power to issue "necessary" or "appropriate" orders to ensure a debtor's compliance with Section 521 of the Code. Importantly, the Court emphasized a bankruptcy judge can go so far as to order a debtor to take action or refrain from taking action in a legal proceeding elsewhere.

Final Observations

Failla may be considered a resounding victory for mortgage lenders—particularly lenders in Alabama, Florida, and Georgia, where it is now binding precedent within the federal court system. *Failla* is also a good reminder that bankruptcy courts can even reopen a debtor's bankruptcy case to protect the integrity of the bankruptcy process. However, it is important to point out that the couple in *Failla* never disputed the validity of the underlying debt to Citibank or the fact that the mortgage loan balance exceeded their home's value. It will be interesting to see how *Failla* is applied by bankruptcy courts when there is also a dispute regarding the underlying debt.