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Feature

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Silence Is Golden?

Rose *and Its Focus on Real Property Surrendered in Chapter 13*

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In July 2014, the U.S. Bankruptcy Court for the Western District of North Carolina addressed whether chapter 13 debtors can compel mortgage creditors to foreclose, repossess or otherwise take title to real property.[1] In *Rose*, the debtors confirmed a plan providing for the surrender of a Florida residence with a scheduled value of $30,000, encumbered by an estimated mortgage debt of $78,653.47, held by the U.S. Small Business Administration (SBA).

Two years after filing for chapter 13, the debtors filed a motion seeking authority to quitclaim the property to the SBA because the SBA had not foreclosed its interest in the property and the debtors were continuing to incur post-petition liabilities such as *ad valorem* taxes and maintenance costs. In short, the debtors desired to permanently disavow further responsibility for the property.

The court ultimately concluded that neither the Bankruptcy Code[2] nor Florida state law[3] permitted the court to compel the SBA to foreclose or accept title to the property by a quitclaim deed. However, in a clever work-around, the court authorized the debtors to deliver a quitclaim deed to the SBA *and* record it if the SBA's actions (or lack thereof) demonstrated acquiescence under applicable Florida law.

In a well-reasoned order, the *Rose* court first confirmed that "surrender" of property under 11 U.S.C. § 1325(a)(5)(C) does not alter a creditor's substantive rights with respect to the property.[4] Agreeing with the majority of the courts to consider this issue, the court confirmed that a secured creditor cannot be compelled to take *affirmative* action related to collateral surrendered under § 1325. As long as the creditor's actions do not "constitute a subterfuge intended to coerce payment of a discharged debt, the secured creditor ... has the prerogative to decide whether to accept or reject the surrendered collateral."[5]

Similarly, the court considered whether 11 U.S.C. § 1322(b)(9) requires a creditor to accept title to property and concluded that it does not.[6] While § 1322(b)(9) contemplates that a plan may re-vest property in the debtor or other entities, it does not state whether such relief can be imposed on a third party at the debtor's unilateral election (*i.e.*, against a creditor's will). Pointing to various undesirable policy implications that are discussed in further detail below, the court declined to adopt an interpretation of this Code section that would allow debtors to force title upon secured creditors against their will. At the time that the *Rose* opinion was rendered, only one published opinion had ever interpreted § 1322(b)(9) to require a lender to accept title to real property.[7] Notably, since *Rose*, at least one other court has adopted this contradictory position.[8]

Next, the court considered whether the broad equitable powers in § 105 provide authority to compel acceptance of the title, but rejected such an interpretation. While bankruptcy courts have fashioned relief under § 105(a) in a wide variety of situations, § 105 does not allow courts to alter the substantive rights of the parties. Rather, the powers granted by

1 *In re Jeffrey Rose*, 512 B.R. 790 (Bankr. W.D.N.C. 2014).
2 11 U.S.C. § 101, *et seq.*
3 Although the bankruptcy case was filed in the U.S. Bankruptcy Court for the Western District of North Carolina, the property was located in Florida, and therefore Florida non-bankruptcy law applied. *See* Viktoria A. D. Ziebarth, "Choice-of-Law Rules in Bankruptcy: An Opportunity for Congress to Resolve Conflicting Approaches," 5 *Seventh Circuit Rev.* 309, 322 (2010) ("[T]he rule applied for real property disputes is the law of the state where the property is located.") (citing William L. Reynolds and William M. Richman, *The Full Faith and Credit Clause: A Reference Guide to the United States Constitution* 20 (Jack Stark ed., Reference Guides to the U.S. Constitution, Nov. 15, 2005)).
4 Section 1325(a)(5)(C) provides that a chapter 13 plan may be confirmed if, among other alternatives, "the debtor surrenders the property securing such claim to such holder."
5 *In re Rose*, 512 B.R. at 794 (internal citations omitted).
6 Section 1322(b)(9), provides in relevant part: "(b) Subject to subsections (a) and (c) of this section, the plan may — ... (9) provide for the vesting of property of the estate, on confirmation of the plan or at a later time, in the debtor or in any other entity."
7 *In re Rose*, 512 B.R. at 795 ("To date, only one published decision has ever read this Code section to require a lender to accept title to a property. *See In re Rosa*, 495 B.R. 522 (Bankr. D. Haw. 2013).").

§ 105 must be exercised in a manner that is consistent with the other Code provisions and other applicable nonbankruptcy law.[9] This begs the following question: What are the parties' rights under applicable nonbankruptcy law?

In Florida, a lender may not be compelled to accept title to property because a transfer of real property is not effective unless and until a deed is delivered *and accepted* by the grantee.[10] Permitting debtors to use the Bankruptcy Code to unilaterally vest title in a secured creditor would contradict the well-established requirement of acceptance, which is a basic tenet of property law incorporated in one way or another by common law and by state statutes in all 50 states.[11]

The rationale for requiring the acceptance of a deed conveyance is well recognized. There are substantial costs for the unwilling grantee: property taxes, hazard insurance, utilities, association dues, maintenance, environmental liabilities and depressed market values, among others. Perhaps the biggest concern is that requiring a first-mortgage lender to accept a title by quitclaim deed would eviscerate the lender's bargained-for first-priority lien position by vesting the title in the first-mortgage lender subject to junior liens. The deed-acceptance requirement protects a lender from inheriting these undesired liabilities and generally promotes the public interest in affordable lending. For these reasons, the court declined to compel the SBA to accept title to the property.

Notwithstanding, the court stated that the debtors may still achieve their desired transfer of the title if the SBA were to acquiesce under state law. Under some circumstances, acceptance can be implied or presumed by the grantee's conduct. For example, in Florida, after a grantee obtains knowledge of the deed, its acceptance of the property might be inferred from its conduct, including (1) failing to renounce the deed, (2) retaining possession of the property, (3) conveying or mortgaging the property or (4) otherwise exercising the rights of an owner of the property.[12] By contrast, a lender may avoid taking the title by simply objecting to the conveyance.[13]

In this case, the court held that there were not sufficient facts to support a conclusion that the SBA was willing to accept the proposed transfer. However, having previously failed to exercise its foreclosure rights and having ignored the debtors' motion, a hearing and a post-hearing opportunity to brief these matters, the SBA's indifference came "very close to supporting a presumption of acceptance" under Florida law.[14] Nonetheless, since an actual deed had not yet been delivered to the SBA, the court afforded the SBA with a final opportunity to state its position on the conveyance before the property would be deemed conveyed.

The court denied the debtors' motion but allowed the debtors to prepare and deliver to the SBA an executed quitclaim deed. The court's order required the SBA to take one of the following actions within 60 days from delivery of the quitclaim deed: (1) record the deed and thereby accept ownership of the property; (2) reject the deed and the proposed conveyance through a written document filed with the court and served on the debtors' counsel; or (3) initiate a foreclosure against the property, thereby indicating rejection of the proposed conveyance by quitclaim deed. If the SBA failed to take any action, the debtors would be authorized to record the quitclaim deed in the applicable Florida registry and thereby transfer the record title to the SBA, which would be deemed a final conveyance not subject to later repudiation.

So where does this leave secured creditors after *Rose*? Courts nationwide generally agree that nothing in the Bankruptcy Code requires a secured creditor to accept possession of surrendered collateral, which was the court's holding in *In re Pratt*, a case cited in all 11 circuits, as well as the D.C. and Puerto Rico circuits.[15] Further, most courts generally agree that the decision of whether to foreclose and/or repossess collateral is purely voluntary and discretionary, thus "a plan cannot require a secured creditor to accept a surrender of property or take possession of or title to it through repossession or foreclosure."[16] In other words, under current law, assuming that applicable state law requires an acceptance of a deed transfer, mortgage lenders are under no affirmative obligation to accept a title to real property that has been surrendered through bankruptcy, and the majority of courts agree that title to a property cannot be vested in an unwilling third party through confirmation. However, there is one important caveat recognized by the *Rose* court: Lenders cannot sit idly while a debtor files pleadings or tenders conveyance documents for a lender's review.

In re Rose and predecessor cases like *In re Arsenault*, *In re Canning* and *In re Pratt* are important decisions for secured creditors; however, they do not address the underlying problem: The debtor remains in title to the property until foreclosure, or until a lender takes some action or "inaction" to accept ownership, and therefore, the debtor continues to be responsible and liable for insurance costs, *ad valorem* taxes and the upkeep and maintenance on the property — despite the fact that the debtor no longer resides there. Reasonable minds can agree that neither the debtor nor the mortgage

8 *See In re Nicholas Watt*, 2014 WL 5304703 (Bankr. D. Or. 2014). In *Watt*, the chapter 13 debtors owned real property subject to homeowner's association (HOA) assessments. *Id.* at *1. In an effort to surrender and terminate all liability relating to their real property, the debtors sought confirmation of a plan that would vest all of their legal and equitable rights in the name of the secured lender. *Id.* Specifically, the proposed chapter 13 plan stated that "[u]pon entry of an Order Confirming this Chapter 13 Plan, the property … shall be vested in [the lender] its successors, transferees or assigns pursuant to ... [§] 1322(b)(9). This vesting shall include all of [the] Debtors [sic] legal and equitable rights. This vesting shall not merge or otherwise affect the extent, validity, or priority of any liens on the property. [The] Creditors potentially affected by this paragraph include: [the lender], [the tax assessor] and the [HOA]." *Id.* The secured lender objected to confirmation based on the vesting provision in the proposed plan. *Id.* at *2. While confirmation was pending, the secured lender filed a motion for stay relief. *Id.* The debtors asserted that (1) their proposed chapter 13 plan sought to vest title in the property in the name of the secured lender pursuant to 11 U.S.C. § 1322(b)(9); and (2) the debtors were willing to execute documents, as necessary and as requested by the secured lender, to perform such vesting. *Id.* The HOA objected to stay relief until the vesting issues could be resolved. *Id.* After an evidentiary hearing, the bankruptcy court granted stay relief to the secured lender. *Id.* at *3. Ultimately, the court concluded that the Code did not prohibit the debtors from surrendering the real property and vesting title in the secured lender's name during the confirmation process. *Id.* at *7. Disagreeing with the majority view espoused by *Rose*, the bankruptcy court focused on the statutory language allowing a proposed plan to "provide for the vesting of property of the estate, on confirmation of the plan or at a later time, in the debtor or in any other entity." *Id.* at 4 (citing 11 U.S.C. § 1322(b)(9)). A statutory interpretation, according to the Watt court, dictated that § 1322(b)(9) permitted confirmation of a proposed plan provided for the vesting of the property in a third party, such as a lienholder, without a party's consent, provided that the plan was proposed in good faith. *Id.* at *5-6.

9 *In re Rose*, 512 B.R. at 795 ("There is no published case law construing Section 105 to permit a debtor to transfer property to its mortgage lender by fiat. This decision will not be the first.").

10 *Id.* (citing *Berry v. Berry*, 992 So. 2d 898, 899 (Fla. Dist. Ct. App. 2d Dist. 2008), *review dismissed*, 2 So. 3d 981 (Fla. 2009)).

11 14-81A *Powell on Real Property* § 81A.04 (2014), Matthew Bender & Co. Inc., a member of the LexisNexis Group. VI Acquisition and Transfer of Interests in Land, Chapter 81A Transfer by Deed ("The mere delivery of a deed by the grantor is insufficient for an effective conveyance. The grantor cannot thrust the property onto the grantee against his or her will, even if the conveyance is gratuitous. To complete the transaction, the grantee must accept the conveyance.").

12 *In re Rose*, 512 B.R. at 797 (citing *Riehl v. Bennett*, 142 So. 2d 761, 763 (Fla. Dist. Ct. App. 2d Dist. 1962)).

13 *Smith v. Owens*, 91 Fla. 995, 1000 (Fla. 1926).

14 *See In re Rose*, 512 B.R. at 797.

15 *Pratt v. Gen. Motors Acceptance Corp. (In re Pratt)*, 462 F.3d 14, 18-19 (1st Cir. 2006).

16 *See, e.g., Arsenault v. JP Morgan Chase Bank NA (In re Arsenault)*, 456 B.R. 627 (Bankr. S.D. Ga. 2011) (quoting W. Homer Drake, Jr., Paul W. Bonapfel and Adam M. Goodman, *Chapter 13 Practice and Procedure* § 9C:9 at 682 (2010-11 ed.)); *see also Canning v. Beneficial Main Inc., et al. (In re Canning)*, 442 B.R. 165 (D. Me. 2011) (stating that mortgage lender does not violate discharge injunction by failing to foreclose upon or release its mortgage on valuable real estate surrendered through bankruptcy). *In re Canning* has been followed by courts in the First, Fourth, Sixth and Eleventh Circuits.

lender has committed any wrong, but this result will not satisfy the debtor, who expects to emerge from bankruptcy with a "fresh start," free from any ongoing liability related to property that they have "surrendered" to their secured lenders as allowed by the Code.[17]

To address this issue, the debtor's bar will continue searching for creative ways to effectively transfer surrendered property within the confines of the Code and applicable state law, and the case law will continue to develop, as *Rose* exemplifies. Other courts have produced different, less creditor-friendly results. In a recent unpublished decision from the U.S. Bankruptcy Court for the Eastern District of North Carolina involving a similar motion, one bankruptcy judge entered an order requiring foreclosure and, in the event that the foreclosure was not timely initiated, authorized conveyance by delivery and the recording of a quitclaim deed.[18] In another decision more akin to *Rose*, another court authorized the delivery of a quitclaim deed to the lender that allowed 10 days for the lender to object and assert nonacceptance of the quitclaim deed.[19] In both of these cases, the lender did not raise any defenses, and neither court identified a legal basis for its holdings, which raises questions about the precedential value of these orders going forward.

The lesson to be learned is that while very strong precedent supports the proposition that a lender may not be compelled to take title to collateral that has been surrendered in bankruptcy, a lender may not sit quietly and neglect to assert its bankruptcy and state law claims, or the lender may find itself in a position where the only options are to accept title subject to junior liens, or to pursue an expensive appeal.[20] abi

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17 *See In re Cormier*, 434 B.R. 222, 224 (Bankr. D. Mass. 2010), for additional discussion of the "important questions regarding the interplay between the rights of mortgage holders and those of financially-strapped property owners seeking relief under the Bankruptcy Code."
18 *See In re Perry*, 2012 Bankr. LEXIS 4731 (Bankr. E.D.N.C. 2012).
19 *In re Williams*, No. 10-06243-8-SWH (Bankr. E.D.N.C. Jan. 30, 2014).
20 Perhaps Sen. Charles E. Schumer (D-N.Y.) said it best: "Inaction is perhaps the greatest mistake of all." *See* www.brainyquote.com/quotes/quotes/c/charlessch167867.html.