On bankruptcy issue, state courts reach different conclusions

By: Donald Lassman August 24, 2017

Two recent state court decisions came to very different conclusions about the impact of pleadings filed in bankruptcy proceedings on subsequent litigation involving challenges to a foreclosure sale.

The decisions are particularly timely and instructive given the escalating litigation and creative defenses occurring in many state courts over the validity of foreclosure sales conducted after the Great Recession that began in 2008.

The decisions also are significant because it is unusual for state courts to delve so deeply into, and require resolution of, as-yet-unanswered questions of federal bankruptcy law, a trend that is likely to continue as the foreclosure battlefield continues to expand.

In *Schiavone v. Kiah*, 24 LCR 798 (2016), an action commenced in Land Court in April 2014, the Schiavones contested the validity of a 2012 foreclosure sale conducted by Deutsche Bank National Trust Co. on their principal residence.

Deutsche defended the action, asserting that the Schiavones were barred from challenging the validity of the foreclosure sale under principles of judicial estoppel because of assertions they made in schedules filed in their May 2011 Chapter 7 bankruptcy proceeding.

The Land Court reviewed the Schiavones' bankruptcy schedules and noted that while the debt to Deutsche was scheduled as a secured claim, no claims against Deutsche were scheduled as assets.

The court also noted that the statement of intention filed by the Schiavones indicated their intent to surrender their home, the property was surrendered, the Schiavones received a discharge of their obligation to Deutsche, and the bankruptcy case was closed in September 2011.

Finding that the Schiavones had ample opportunity to discover the facts supporting their present challenge to the foreclosure sale at the time the bankruptcy case was filed, the court ruled that the Schiavones were compelled to disclose their claims against Deutsche in their bankruptcy pleadings, and their failure to do so constituted an "affirmative acknowledgement" of the validity of Deutsche's mortgage. They were barred from later asserting a contrary position and challenging the validity of the foreclosure sale, the court ruled. (A similar result was reached by the Land Court in its November 2016 decision in *Fitchburg Capital LLC v. Bourque*, 2016 Mass. LCR Lexis 184 (2016)).

The Land Court further found that the Schiavones were conclusively barred from asserting any claims to their property by the representation in their statement of intention that they were surrendering their home in return for a discharge of their debts. This harsh result might have been avoided had the Schiavones sought to amend their bankruptcy schedules to include the causes of action against Deutsche.

'Everbank v. Chacon'

Most recently, the Appeals Court explored the impact of the statement of intention on a debtor's later efforts to set aside a foreclosure sale.

In *Everbank v. Chacon*, 2017 Mass. App. Unpub. Lexis 761, the Appeals Court was asked to "weigh in on a particularly muddy area of bankruptcy law: what it means for a Chapter 7 debtor to state an intention, pursuant to 11 U.S.C. §521(a)(2) (2012), to 'surrender' property of the bankruptcy estate that secures a debt listed on the debtor's schedule of assets and liabilities."

Everbank held a mortgage on Chacon's residence, Chacon defaulted, and Everbank foreclosed and then brought a summary process in Housing Court to obtain possession. Chacon defended by challenging the validity of the foreclosure sale.

The Housing Court judge ruled that Chacon was barred from raising the validity of the foreclosure sale as a defense because he had "elected to surrender any interest he had in the mortgage property to Everbank" in the statement of intention filed by Chacon in his Chapter 7 bankruptcy case.

Chacon appealed the ruling, and the Appeals Court focused on the impact of pleadings filed by Chacon in his bankruptcy case on his ability to later challenge the validity of the foreclosure sale.

Chacon filed for Chapter 13 on Jan. 31, 2010, and listed the debt to Everbank as a secured claim. Everbank sought and obtained relief from the automatic stay to foreclose on Chacon's property, and Chacon then converted his Chapter 13 case to Chapter 7 and received a discharge of all of his debts, including his personal liability on his mortgage debt to Everbank. (Everbank's ability to foreclose on its mortgage was not impaired by entry of the discharge order because liens pass through bankruptcy unimpaired unless the Bankruptcy Court orders otherwise.) His bankruptcy case was closed in late 2011.

> *The decisions of the Appeals Court and Land Court are difficult to reconcile.*

Chacon's statement of intention, filed as part of the Chapter 7 proceeding, indicated Chacon was surrendering his home; the Housing Court interpreted that to mean that the property was surrendered to Everbank.

Finding that Chacon had surrendered his home and that the Bankruptcy Court issued Chacon's Chapter 7 discharge order in reliance on Chacon's statement of intention to surrender, the Housing Court concluded that Chacon waived any right to contest Everbank's foreclosure and was barred by the doctrine of judicial estoppel from contesting the foreclosure sale, a result consistent with the Land Court's ruling in *Schiavone*.

The Appeals Court disagreed with the Housing Court and reversed the decision, finding that Chacon was not estopped from challenging the validity of the foreclosure sale by the assertions he had made in his statement of intention and ruling that Chacon could challenge that sale.

The Appeals Court found that Chacon's statement of intention did not manifest an intention to surrender the property to Everbank and indeed was silent as to whom the property was surrendered.

The court further noted that upon case commencement, the Bankruptcy Code provides that all property of a debtor is to be surrendered to the Chapter 7 trustee; that when a case is closed, absent a court order to the contrary, all property is then abandoned back to the debtor; and that entry of a discharge in bankruptcy is not "in any way conditioned on, or entered by the Bankruptcy Court in reliance upon" a debtor's statement of intent to surrender his property.

The doctrines of both waiver and judicial estoppel require a finding that a party's positions are "squarely inconsistent." Noting that the meaning of the term "surrender" and its impact on substantive bankruptcy rights of debtors is the subject of considerable debate among federal courts, the Appeals Court concluded that it could not determine what Chacon meant by electing to "surrender" his home on the bankruptcy statement of intention, and it

was therefore not clear whether Chacon's positon in the bankruptcy case was inconsistent with his position in the Housing Court case.

The Appeals Court found that neither waiver nor judicial estoppel could serve as a bar to challenge the validity of Everbank's foreclosure sale.

Conspicuously absent from the Appeals Court opinion is any reference to the *Schiavone* decision and, more importantly, any discussion of the impact of Chacon's failure to include his claims against Everbank as an asset on his bankruptcy pleadings, which served as an alternative basis for the Land Court's contrary conclusion in *Schiavone* barring his challenge to the validity of the foreclosure sale of his home.

Lessons learned

The decisions of the Appeals Court and Land Court are difficult to reconcile. In *Schiavone*, the Land Court stressed the importance of full and complete disclosure in bankruptcy and demonstrated a willingness to both adopt a plain meaning of statements made by a debtor on its statement of intention, and to impose consequences based on those statements.

The Appeals Court, acknowledging its unwillingness to delve into the meaning of "surrender" and determine the import of the statements made by Chacon on his statement of intention, a document signed under the pains and penalties of perjury, essentially attributed no consequences to the statement of intention whatsoever.

The lessons learned are plain. Debtors and their counsel must think very carefully about any claims that may be asserted against any creditor included on the bankruptcy schedules and fully and completely disclose all claims relating to residential real estate, however trivial they may seem at the time.

Careful thought also must be given to completion of the statement of intention. Many times the statement is not completed. More typically, debtor's counsel will err on the side of caution and select "surrender" to ensure that the client is discharged of personal liability on the mortgage note in the event of a subsequent foreclosure.

However, there is much more to consider now that courts are looking to the statement of intention to determine substantive rights in litigation that may be commenced many years after the bankruptcy case has been closed.

Always amend bankruptcy schedules (and, if necessary, re-open the bankruptcy case to permit the amendment to be filed) to add causes of action that may be discovered only after the bankruptcy case is commenced.

The penalty for failing to disclose causes of action can dramatically impair a debtor's ability to later successfully challenge related legal matters.

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