CREDIT UNION LEGAL NEWSLETTER

COMPLIMENTARY ISSUE

By

Harroun, P.C.

Credit Union Attorneys

In This Issue

- Chapter 13 Bankruptcy - Credit Union Claim Survives Debtors' "Surrender-in-Full" of Real Estate

By: Charles R. Harroun, Attorney at Law

Legal Issue:

WHETHER DEBTORS' CHAPTER 13 PLAN CAN EFFECTIVELY "SURRENDER-IN-FULL" REAL PROPERTY THAT IS NOT THE DEBTORS' PRINCIPAL RESIDENCE AND AVOID THE LENDER FROM ASSERTING AN UNSECURED CLAIM FOR A DEFICIENCY BALANCE.

Background:

When a mortgage borrower files a Chapter 13 Bankruptcy, if the debtor intends to "surrender" mortgaged real estate to the credit union/bank/lender, the debtor attorneys are regularly inserting the following statement, or variation thereof, in the debtor's Chapter 13 Plan: "Debtor surrenders [subject real estate] to credit union in full satisfaction of creditors claim."

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Debtors' statement to "Surrender-in-Full" satisfaction of the entire debt is an attempt to avoid repaying ***any*** of the deficiency balance owing on the mortgage. This would prevent the credit union or lender from asserting a deficiency unsecured claim to be paid through the Chapter 13 Plan at the same rate as other unsecured creditors.

Court Ruling:

In the case of ***In Re: Marlon Leshan Finley and Lesley Nicole Finley***, (Bankr. E.D. Mich. 2009, Case No. 09-44480), decided July 21, 2009, the Court held that 11 U.S.C. §1325(a)(5) and §506(a) of the Bankruptcy Code do not allow debtors to surrender real property in full satisfaction of a creditor's claim.

The Court interpreted sections 11 U.S.C. §1325(a)(5) and §506(a) of the Bankruptcy Code:

11 U.S.C §506(a) of the Bankruptcy Code provides, in pertinent part:

> "An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, ***and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim."***

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11 U.S.C §1325(a) provides, in part:

> ". . . section 506 shall not apply to a claim . . . if the creditor has a purchase money security interest securing the debt that is the subject of the claim, the debt was incurred within the 910-day preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle . . . acquired for the personal use of the debtor, ***or if collateral for that debt consists of any other thing of value,*** **if the debt was incurred during the 1-year period preceding that filing."** [Emphasis Supplied].

Section 1325(a) above is commonly known as the "hanging paragraph" of Section 1325(a). Thus if the debt is more than one-year [910-day rule] old, and secured by anything of value (including real estate), then an unsecured claim for a deficiency balance may be allowed.

Congress specifically amended the Bankruptcy Code under BAPCPA to address concerns of creditors who lend money to those purchasing personal and depreciating property, namely automobiles. However, this Court found "that there is no meaningful distinction, for the purpose of determining the secured status of a creditor's claim, between the surrender of real property and the surrender of a vehicle."

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This Court Opinion above is significant, as it applies the same ruling to ***real estate*** as the case of ***In Re: Long***, 519 F3d 288 (CA 6, 2008) applied to a purchase-money secured ***automobile*.**

In an earlier case, ***In re Hughes***, 402 B.R. 404 (Bankr.M.D.Fla.2008), the Middle District of Florida Bankruptcy Court cited the U.S. Supreme Court case of ***Associates Commercial Corp. v. Rash***, 520 US 953; 117 S Ct 1879; 138 L Ed 2d 148 (1997), and held:

> "The Property constituted property of the estate on the Petition Date pursuant to 11 U.S.C. Sections 541(a) and 1306(a). Wachovia . . . hold[s] an allowed claim.... The surrender of the property may not have fully satisfied Wachovia's claim.
>
> Wachovia, to the extent its claim is under secured, is entitled to file a general unsecured deficiency claim pursuant to 11 U.S.C. Section 506(a)(1). Such deficiency claim should share pro rata in any distribution to other unsecured creditors."

Other Courts have also upheld the creditor's right to file a claim for a remaining deficiency balance subsequent to sale of collateral. See also, ***In Re: Ted and Kim Patricka***, (Bankr. E.D. Mich. 2009, Case No. 06-46162), ***Capital One Auto Finance v. Osborn,*** 515 F3d 817 (CA 8, 2008); ***Wright v. Santander Consumer USA Inc.,*** 492 F3d 829 (CA 7, 2007), and the following circuit court decisions "reached their conclusion that the right to assert an unsecured deficiency claim is protected by reviewing the plain language of the statute." ***Tidewater Fin. Co. v. Kenney,*** 531 F3d 312 (CA 4, 2008); and ***In re Ballard,*** 526 F3d 634 (CA 10, 2008).

Question:

DOES THE CREDIT UNION HAVE BOTH A SECURED CLAIM AND UNSECURED CLAIM?

Answer: Yes

The ***Finley*** case above cited ***In re Brooks***, 2009 WL 1490486 (Bankr. M.D. Fla. 2009) to support the position that the creditor holds both a secured claim, to the extent of the **value** of the collateral surrendered, and an unsecured bifurcated claim for the deficiency.

Brooks Case Guidance:

> "As a general proposition, the prudent approach for the secured creditor who is uncertain of a deficiency should file a bifurcated claim composed of a secured and unsecured portion or, in the alternative, the creditor should file a motion to value the collateral and obtain an order determining the amount of deficiency based on Section 506(a) of the Code."

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Allocating Amounts of Secured & Unsecured Claim(s):

The ***Finley*** Court noted that: "11 U.S.C. §1325(a)(5)(C) is **silent on how to determine the value** of the secured interest in the surrendered property." [Emphasis Supplied].

Hence, the issue remains on how to determine the amounts for the secured and unsecured portions of the bifurcated claim(s).

The ***Finley*** Court held that 11 U.S.C. §506(a)(1) is applicable to determine the value of a secured claim in collateral surrendered pursuant to 11 U.S.C. §1325(a)(5)(C).

> "An allowed claim of a creditor secured by a lien on property . . . is a secured claim to the extent of the **value** of such creditor's interest in . . . such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim." 11 U.S.C. §506(a)(1) [Emphasis Supplied].

Editor's Comment:

In a dispute as to an amount allocated for the secured and unsecured portions of the claim(s), the credit union will need to rely upon documentation and/or an appraisal of the property to determine the portions to apply for the bifurcated secured and unsecured claim(s). It may be necessary for creditors and debtors to schedule valuation hearings for a judicial determination for an allocation of the claim.

A	**Current Value of Collateral – Secured Portion**			**$40,000.00**
B	**Undersecured Amount – Unsecured Portion**			**$10,000.00**
A	**+**	**B**	**Total Claim(s)**	**$50,000.00**

Example

New Michigan Foreclosure Laws

See Insert

Credit Union Violates "Stay" with Payroll Transfer

See Insert

Credit Union Bankruptcy & Foreclosure Law Seminar

See Insert or visit www.harrounpc.com

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MICHIGAN'S NEW FORECLOSURE LAW AND WHAT EVERY CREDIT UNION NEEDS TO KNOW

By: James J. Makowski
Attorney at Law

Effective July 5, 2009

The requirements for commencing a foreclosure by advertisement have changed. The Michigan Legislature amended the Revised Judicature Act in an attempt to slow the growing number of foreclosures in the state. The purpose of the new amendments is to require mortgage lenders that wish to foreclose by advertisement to attempt loan modifications before foreclosing.

Two aspects of the new law are important to note. First, these changes only affect foreclosures on a homeowner's personal residence. Vacation or rental property foreclosures are not affected. Second, lenders still have the right to proceed with judicial foreclosures and these changes to the law will not apply to those lenders electing to foreclose judicially.

Prior to the amended laws taking effect, a borrower with a 60-90 day delinquency would be sent a "30-day" letter providing notice of acceleration. If the borrower failed to cure the delinquency during the acceleration period, the lender would commence publication and start the foreclosure process.

The amended statute adds another step to the foreclosure process. Lenders are now required to send a second notice. This letter must provide a contact name and telephone number for a representative of the lender with power to negotiate loan modifications. The letter must also provide information to a borrower as to how to seek legal help in retaining the home. Enclosed with the letter must be a list of "housing counselors" approved by the state. The letter must specify the nature of the default and the steps a borrower can take to cure the default. This notice must also include sources to aid a borrower to locate local legal representation, such as a community legal aid hotline and the State Bar of Michigan's Lawyer Referral telephone service.

In addition, within seven days of sending this second notice to the borrower, the lender must publish a notice of intent to foreclose in the newspaper of record for the county in which the property is located. This notice must provide much of the same information as the letter, including the name and telephone number of the lenders' designated contact person. This will obviously add significant costs to the acceleration letter process.

A key aspect to both the new letter and the new statute is the requirement that lenders agree to meet with borrowers to discuss their account. This meeting must take place at a "mutually convenient" location or the county in which the property is located. Should a borrower request such a meeting the foreclosure is automatically suspended for a ninety (90) day period.

Lenders wishing to foreclose by advertisement must now offer to modify loans to qualified homeowners. Should a borrower contact a lender requesting a loan modification, the lender is required to perform an analysis of the borrowers' income and housing related expenses. The lender must offer to, among other things: reduce the interest rate to a 3.00% floor for a minimum of at least five (5) years; extend the term of the loan to a maximum of forty (40) years, waive some or all late fees and possibly reduce the principal amount owed on the loan. Once a loan modification offer is sent out the borrower must return an executed copy within 14 days after receipt.

If a lender fails to follow the new requirements borrowers can seek injunctive relief from the circuit court to enjoin the lender from foreclosing.

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