CONSUMER BANKRUPTCY

"I Surrender" Does Not Mean I Surrender — Mortgagee Can't Hold Statement of Intention Against Debtor in Foreclosure Case

By Craig D. Robins

In my November 2017 column, "'I Surrender!' What Does That Mean?," I discussed the situation where a Chapter 7 consumer debtor declares in the "Statement of Intention" schedule to the petition, his or her intention to surrender their home, and what that declaration actually means.

At the time, many debtors later discovered to their dismay that declaring an intention to surrender their home precluded their ability to defend a state court foreclosure case. This was because foreclosing mortgagees would argue that the doctrines of waiver and judicial estoppel bar a debtor from taking a later, supposedly contrary position, even if that is many years after the bankruptcy case is over.

When I wrote my earlier article, courts around the country were split as to whether a debtor's declared intention to surrender property in a bankruptcy proceeding could prevent the debtor from later defending a foreclosure proceeding, and there was no authoritative case law in our jurisdiction.


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However, during the midst of our coronavirus pandemic, the United States District Court for the Eastern District of New York addressed this issue and held in favor of the debtor, essentially saying that a debtor who indicates a surrender of property in the bankruptcy petition should not be prevented from defending a state court foreclosure proceeding and contesting the validity of the mortgagee's right to foreclose. *Federal National Mortgage Association ("Fannie Mae") v. Alarcon*, 19-cv-5079, 2020 WL 3104034 (E.D.N.Y, June 11, 2020)

In *Alarcon*, which started out as a routine consumer Chapter 7 filing in 2014, the debtor owned a mortgaged house in Queens. As part of the filing, the debtor completed the "Statement of Intention" form which, pursuant to Bankruptcy Code § 521(a)(2), required the debtor to declare his intent with regard to his secured property. He checked the box to indicate his intent to "surrender" his home. About four months after filing, the court routinely granted a discharge and closed the case.

Three years later, in 2018, Fannie Mae commenced a foreclosure action in Queens County Supreme Court. The debtor filed an answer with counterclaims asserting the statute of limitations. According to the debtor, the statute of limitations expired in 2015, making the mortgage unenforceable.

Fannie Mae believed they had an opportunity to prevent the debtor from pursuing that defense, so in August 2019, it moved the Bankruptcy Court for an order to reopen the Chapter 7 case, arguing that because the debtor indicated he intended to surrender the house in his Statement of Intention, he had no right to contest the foreclosure action. Fannie Mae asked the Bankruptcy Court to "enforce the surrender" by ordering the debtor to stop contesting the foreclosure.

Judge Nancy Hershey Lord, sitting in the Brooklyn Bankruptcy Court, heard oral argument at which the debtor did not appear. Fannie Mae argued that when the debtor chose to surrender the property, he chose to give up all rights to the property, and by raising the statute of limitations, the debtor was "trying to get the property for nothing."

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REAL PROPERTY

Federal Eviction and Foreclosure Moratoriums Invite Litigation

By Andrew Lieb


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The Coronavirus Aid, Relief, and Economic Security Act (CARES Act)'s §§4022(b) & (c)(2) provides for foreclosure forbearances and a foreclosure moratorium on 1- to 4- family properties; §§4023(b), (c), (d), & (e) provides for foreclosure forbearances and a corresponding eviction moratorium on multifamily properties; and §§4024(b) & (c) provides for an eviction moratorium on both 1- to 4- family properties and multifamily properties.

These moratoriums have made headlines everywhere, but how do they functionally work? None of the three statutory sections includes a penalty for violations, which was brilliantly reported by Annie Nova in her piece in CNBC's Personal Finance section, "How the CARES Act failed to protect tenants from eviction." Therefore, we are left with enforceability through litigation when a plaintiff elects to prosecute a case in the face of the moratoriums. Should that transpire, there are two main issues that counsel should be mindful of in defending the suit, including applicability and proof.

As to applicability, as is typical of legislation, the devil is in the details. §4022(a)(2)'s definition of a federally backed mortgage loan differs from §4024(a)(4)'s definition of the same term, to wit:

§4022(a)(2) defines the term as a loan:

> which is secured by a first or subordinate lien… (A) insured by the Federal Housing Administration under title II of the National Housing Act (12 U.S.C. 1707 et seq.); (B) insured under section 255 of the National Housing Act (12 U.S.C. 1715z-20); (C) guaranteed under section 184 or 184A of the Housing and Community Development Act of 1992 (12 U.S.C. 1715z-13a, 1715z-13b); (D) guaranteed or insured by the Department of Veterans Affairs; (E) guaranteed or insured by the Department of Agriculture; (F) made by the Department of Agriculture; or (G) purchased or securitized by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association.

§4024(a)(4) defines the same term as a loan:

> is secured by a first or subordinate lien…made in whole or in part, or insured, guaranteed, supplemented, or assisted in any way, by any officer or agency of the Federal Government or under or in connection with a housing or urban development program administered by the Secretary of Housing and Urban Development or a housing or related program administered by any other such officer or agency, or is purchased or securitized by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association.

As to multifamily mortgage loans, the same definition exists at §4023(f)(2) & §4024(a)(5) as a loan that:

> is made in whole or in part, or insured, guaranteed, supplemented, or assisted in any way, by any officer or agency of the Federal Government or under or in connection with a housing or urban development program administered by the Secretary of Housing and Urban Development or a housing or related program administered by any other such officer or agency, or is purchased or securitized by the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association.

Nonetheless, while §4022 only applies to properties with federally backed mortgage loans and §4023 only applies to properties with federally backed multifamily mortgage loans, §4024 applies to both federally backed

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Fannie Mae asked the court to follow *In re Failla*, 838 F.3d 1173 (2016), a widely-cited Eleventh Circuit decision which held that "surrender" requires debtors to drop their opposition to foreclosure actions. The Failla decision further held that bankruptcy courts have the power to compel debtors not to oppose a foreclosure action in state court.

However, Judge Lord denied Fannie Mae's motion. Opining in a colorful manner, the judge stated that a debtor's marking his intent to "surrender" property in his bankruptcy petition "in the practical world doesn't really mean a whole lot."

Judge Lord explicitly disagreed with *Failla's* conclusion – that a debtor's checking the "surrender" box means that he gives up all rights to the property – expressing that "in Brooklyn that's not the way this works." The Bankruptcy Court ultimately saw no basis on which to order the debtor not to contest the foreclosure action. This led Fannie Mae to appeal to the District Court.

The debtor did not appear in the appeal either, yet the District Court affirmed the Bankruptcy Court's decision and Fannie Mae lost. District Court Judge Allyne R. Ross clearly rejected *Failla*, stating, "In sum, the bankruptcy court declined to save Fannie Mae from its own failure to abide by the statute of limitations in state court by reopening a case to adopt an out-of-circuit rule that would afford significantly more weight to a checkmark on a several-year-old form than was required in this circuit." The District Court continued, "Absent any binding Second Circuit precedent on the issue, such a decision was well within the bankruptcy court's discretion."

The District Court adopted Judge Lord's position that the Bankruptcy Court only accords limited significance to the "surrender" checkmark box. Fannie Mae tried to argue that if a debtor is represented by counsel who prepares the petition, the debtor certainly must understand the implications of checking the "surrender" box. However, Judge Ross held that even when a debtor is fully informed, the "surrender" checkmark has limited significance in the Eastern District of New York and cannot save Fannie Mae from a state-court statute of limitations. Thus, Judge Ross concluded that the Bankruptcy Court acted within its discretion in determining that cause did not exist to reopen the bankruptcy case, meaning that it could not award relief to Fannie Mae.

Practical Tips. Even with this new decision, debtors should avoid checking the "surrender" box on the Statement of Intention. Why ask for trouble? Although the Bankruptcy Court in Alarcon refused to reopen the case to accord relief to the mortgagee, Judge Lord noted that the mortgagee could have still raised this issue in state court.

In addition, debtors should consider listing mortgage debts as disputed and include, as an asset, a claim against the mortgagee. Although this would probably result in the trustee asking additional questions, doing so would mean that the debtor would have a claim or dispute against the mortgagee that could survive the bankruptcy case and be litigated as part of the foreclosure proceeding.

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mortgage loans and multifamily mortgage loans plus covered properties, which also includes "a covered housing program (as defined in section 41411(a) of the Violence Against Women Act of 1994 (34 U.S.C. 12491(a))); or (ii) the rural housing voucher program under section 542 of the Housing Act of 1949 (42 U.S.C. 1490r).

As to proof, defense counsel should leverage tailored discovery demands to prove applicability because it is unlikely that clients will have suitable documentation in their possession at the onset of suit to support a motion to dismiss. As a result, counsel should always include an affirmative defense in their clients' Answers, that the lawsuit violates the CARES Act, in situations where the lawsuit was commenced during the moratoriums. Then, counsel should make pointed disclosure demands in a Demand for Discovery and Inspection. Finally, counsel should leverage a Notice to Admit and/or interrogatories to confirm the same.

Yet, the biggest issue from the CARES Act is not its lack of a penalty or difficulty in determining/proving applicability. Instead, the biggest issue is the false expectations that clients have conjured up in response to the headlines. Many laymen wrongfully believe that the CARES Act prevents suit and, as a result, if suit is brought, they can just ignore it. Clients read the headlines, but not the statutory text. They need to be advised to the contrary with a uniform vigor from all members of the bar.

To make matters worse, and more ambiguous, on August 27, 2020, the Federal Housing Finance Agency issued a press release titled "FHFA Extends Foreclosure and REO Eviction Moratoriums." The press release states, in pertinent part, as follows:

> Fannie Mae and Freddie Mac (the Enterprises) will extend the moratoriums on single-family foreclosures and real estate owned (REO) evictions until at least December 31, 2020. The foreclosure moratorium applies to Enterprise-backed, single-family mortgages only. The REO eviction moratorium applies to properties that have been acquired by an Enterprise through foreclosure or deed-in-lieu of foreclosure transactions. The current moratoriums were set to expire on August 31, 2020.

As such, the FHFA guidance represents an entirely different applicability statement than existed in any of the three moratorium sections of the CARES Act. Counsel is therefore charged with the need to further clarify this applicability because the CARES Act's moratorium expired on July 25, 2020 and the new FHFA moratorium expires on December 31, 2020. Clients need uniform advice to defend every lawsuit, irrespective if they believe that a moratorium is applicable. Otherwise, we will be spending next year litigating motion to vacate default judgments.

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mon charge release can bolster an argument for delaying performance.

- With the state of affairs in NYC, has the seller of the replacement property received a better pre Covid price as compared to any new post Covid deal. (Articles on the decreasing NYC property values are flooding the market). This combined with the realtor who stands to lose substantial money on a lost commission and who may volunteer to "kick in" some money to keep the deal alive, may be enticing to the seller.

The transactional attorney must first reject any "TOE" declaration as "unreasonable" given the pandemic. A failure to so reject the "TOE" declaration can prove fatal. Next, a careful examination of the contractual language may provide further ammunition for negotiating a delay in performance without a default.

As with most real estate purchases, the purchaser has a right to a pre closing inspection. Remember, this property is being purchased subject to the existing tenants and with a tenant's reluctance to socially interact and quarantine themselves, arranging a "safe and healthy" final inspection or arguing that same cannot be accomplished (tenants are not allowing an inspection or purchaser is not comfortable with conducting the inspection) as a condition precedent to scheduling a closing can be asserted as rejecting a "TOE" declaration.

Covid protocol and other quarantine "tactics" can be asserted as need be depending on what you are trying to accomplish. In the client's case, negotiating a delay in the closing was the goal, however if this were not the strategy then negotiating a cancellation of the contract would have been via the "willful" default language.

By establishing that the purchaser is involved in a 1031, despite the contact not being subject to the 1031 exchange (which in hindsight would have been the optimum contingency), the failure of the underlying 1031 sale to take place could provide the basis for defending a "willful" default and affirmatively seeking a return of the contract deposit.

For the client, maintaining the contract, with an adjourned closing date (at no or little additional cost) was the goal. Taking a stance based on what Covid-19 facts are available while fending off a "TOE" declaration and ultimately concluding the 1031 exchange is your Action in the TransAction.

Note: Irwin S. Izen, is a solo practitioner, concentrating on real estate, business and transactional law. He is the former co-chairman of the Transactional & Corporate Law Committee and is the past co-chairman of the Suffolk County Bar Association Real Property Committee. He represents both individuals and small businesses in purchase and sales, real estate matters and other transactions facing the entrepreneur and maintains his office at 357 Veterans Memorial Highway, Commack, New York 11725 and can be reached via email at Izenlaw@aol.com.