

CHAPTER 13 BANKRUPTCY SEMINAR ON MORTGAGE ISSUES INVOLVING THE 2005 BANKRUPTCY REFORM ACT

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There are an enormous number of significant changes to the new bankruptcy laws. Most of the changes go into on October 17, 2005; some went into effect on April 20, 2005, when the President signed the new bill. Below are highlights of the new law as it will effect consumer debtors insofar as mortgages and deed of trusts are concerned.

1. Section 362(c).

This Section is amended to say, in effect, that in a second consecutive case, where the second case is filed within a year of the first case, and the first case was dismissed for a reason other than Section 707(b), the automatic stay in the second case lasts for only 30 days from the date of the petition. However, the debtor can file a motion for a stay, and such motion must be heard and completed within that 30 day period. This motion must show the case was filed in good faith. There is now a presumption that the second case was not filed in good faith if

(1) as to all creditors, (A) if there was more than one prior case within a year; or (B) the prior case was dismissed after the debtor failed to file the necessary documents; or (C) provide adequate protection, or (D) complete a plan; or there has not been a substantial change in financial or personal affairs; or

(2) as to any creditor that filed a motion for relief from stay in the prior case, in the most current case is filed in bad faith if the motion was filed in the prior case resulting in relief or an APO.

Also, if a debtor files a case, and had 2 or more prior cases within the previous year but were dismissed (other than under Section 707(b)), the stay does not go into effect when the 3rd case is filed. A party can file a motion asking the court to rule that there is no stay. Within 30 days of the petition, the debtor can file a motion for stay, with notice and a hearing, & the debtor must show the recent case is filed in good faith. The same presumption applies here as above. The motion for the stay was be heard and completed within this thirty day period.

Under this new law, mortgage lenders must be aware of the prior cases to determine if there is an automatic stay, and of the lender can proceed with their foreclosure sale. In the second case, the stay expires after thirty days if there is no order continuing the stay. The lender can proceed with their foreclosure action if the debtor does not obtain a continuance of the stay. In the third case, the lender can proceed with its foreclosure action unless it receives notice that the court has imposed a stay. Lenders need to be aware of prior cases, and their counsel should thus search Pacer to determine if there are prior cases when a lender refers a bankruptcy case to the attorney. Please note that this Section applies to the debtor only. So, if a prior case was filed by a different debtor, this new Section is inapplicable, and there likely will be an automatic stay under Section 362(a).

2. Section 362(d)(4)

This Section is also new. It says, in effect, that for creditors with real property collateral, if the court determines the case was filed was part of a scheme to delay, hinder and defraud any creditor involving (1) an unauthorized transfer of an ownership interest in the property; or (2) multiple filings affecting the real property, the court can grant relief from the stay and the order granting relief, upon recording in the county recorder's office where the property is located, is in rem for 2 years.

So, the lender needs to prove the petition was part of a scheme to delay, hinder and defraud any creditor. If the property is in foreclosure, there likely can be strong argument that the petition was filed to stop the sale. If there are multiple cases repeatedly stopping the sale, the lender's argument becomes stronger. Counsel for the lender should look at the timing of the origination of the loan in relation to the payment default and the multiple filings. Moreover, the transfer of the ownership interest should be reviewed to determine how many transfers and whether these transfers are for fractionalized interests. However, it appears this new Section would not cover the situation where one places a junior lien and deed of trust against a real property. This situation does in fact arise. Here, the junior lienholder would not have an "ownership" interest, and thus Section 362(d)(4) may not apply.

A debtor in a subsequent case can file a motion to be excused from such an in rem order for good cause shown. Mortgage lenders are now afforded certain protection they previously were denied by certain courts. This expanded relief is not absolute, as the debtor can seek to impose the stay, as noted below.

3. Section 362(b)(20)

This is also a new Section and states that the automatic stay does not apply if (1) a lender seeks to enforce its lien against real property from an order under Section 362(d)(4) above for 2 years after the date of entry of that order; or (2) a lender seeks to enforce its lien against real property, and the debtor files a petition in violation of a court order.

In chapter 13 cases where a junior lien is stripped from the property, the new law says that the lien remains on the property until the earlier of (1) the payment of the debt; or (1) the debtor receives a discharge. In other words, a debtor cannot strip the lien in the chapter 13, & then get the plan confirmed, and then a few months later dismiss or convert the case and get the benefit of the stripped lien.

With respect to homestead exemptions, the exemption is reduced to the extent that the value of the homestead is attributable to any portion of the property that the debtor disposed of within 10 years, with the intent to hinder, delay or defraud a creditor that the debtor could not exempt. Also, the homestead exemption was reduced to a maximum of \$125,000 under Federal law, which now supercedes California law on this issue in federal court. This was effective April 20, 2005.

4. Sections 362(b)(22), (23)

This is a new Section and states that certain acts are not in violation of the stay. It says that there is no automatic stay of a UD action by a lessor, when a bankruptcy is filed and where the lessor obtained a judgment pre-petition. This arguably may have been the law already, see Lee v. Baca, 73 Cal. App. 4th 1116, 1118 (1999), however Congress has now expressly stated so.

There is a lengthy exception; if the debtor files a declaration stating he is allowed to cure the default under Ca. law and posts with the clerk the rent for the first month post-petition.

Section (23) says there is no stay if a UD is pending when the bankruptcy is filed, and the property is endangered by the illegal use of controlled substances. However, the lessor must file a declaration under penalty of perjury attesting to this.

5. Section 362(b)(21)

This is a new Section and states that certain acts are not in violation of the stay. There is no stay if of an act to enforce a lien against real property if the petition was filed in violation of a prior order under Section 109(g) of the Code, or if there is an order in a prior case prohibiting the debtor from being a debtor in another case.

6. Section 521(i)

If a debtor does not file all of the required documents (which is the petition, schedules, statement of financial affairs and the balance of the required documents for a complete filing) pursuant to Section 541(a), within 45 days of the petition, the case will be dismissed. The law previously stated a debtor had fifteen days to file the complete documents of the case would be dismissed. This 45 day period can be extended for an additional 45 days if the court finds justification.

7. Section 1325(a)(9)

This is a new Section. Under Chapter 13, for confirmation of the plan, the debtor must have filed all required tax returns for the 4 years before the Petition (pursuant to new Code Section 1308). These returns must be filed before the first date set for the 341. The Trustee or a creditor can ask for copies of the tax returns. In this regard, a lender can seek the tax returns for prior years, cross-reference the information in the tax returns with Schedule I and J, and incorporate them into a plan objection if applicable.

8. Section 1325(a)(8)

Under Chapter 13, for confirmation of the plan, the debtor must be current on all court-ordered post-petition child and spousal support obligations. The Trustee may require proof of the payments. Again, lenders can obtain this information and incorporate it into a plan objection if applicable.

9. Section 1325(a)

This Code Section sets forth the requirements to confirm a plan. For secured debt, Section 506 does not apply, so a cram down is not possible on secured debt (such as a car loan) if the creditor has a purchase money security agreement and the debt was incurred within 910 days (2.49 years) before the petition was filed and the collateral is a vehicle used for personal use, or if the collateral is anything of value if the debt was incurred within 1 year of the petition. **So, if the vehicle is used for business purposes, perhaps even part-time, is a cram down is possible?** Moreover, the lien is not removed until the payment of the debt under non-bankruptcy law or the discharge, whichever is earlier. If a lien is removed, but the debtor then fails to make the payments and the case is dismissed, the lien remains on the property.

10. The Co-debtor Stay Under Section 1301

Section 1301 has **not** been amended. Accordingly, it appears that all of the changes to the automatic stay under Section 362 have no impact on the co-debtor stay under Section 1301. So, if a debtor files a case, and the case is dismissed or for some other reason the debtor is not eligible to file another case, and the debtor does file a subsequent Chapter 13 petition with a co-debtor, it would seem that the automatic stay under Section 362(a) would apply since the co-debtor stay is separate and apart from the automatic stay. Therefore, the lender needs to review the petition to determine precisely who is filing the new petition.