

# PUBLICATION

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## Spotlight on Bankruptcy: Basic Bankruptcy for Mortgage Litigators

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Mortgage litigators often face a variety of bankruptcy issues. There are three main chapters of bankruptcy that affect the average mortgage litigator: Chapter 7, Chapter 13 and Chapter 11. Upon the filing of Chapter 7, Chapter 13 and Chapter 11 by a borrower, the bankruptcy code provides for a bankruptcy automatic stay. The automatic stay provides that all judicial or administrative proceedings or actions against a borrower must immediately stop. This includes all foreclosure actions, eviction actions and general state court litigation against a borrower. In order to proceed with such actions, the creditor must seek stay relief from a bankruptcy judge. Failure to stay such actions can result in actual damages, potential punitive damages and attorneys' fees in favor of the borrower.

### *Chapter 7*

A borrower's goal in filing Chapter 7 is often to liquidate his/her assets and receive a fresh start. Although a borrower can reaffirm certain debts, a Chapter 7 borrower often surrenders most of his/her significant assets. Upon the filing of Chapter 7, an estate is created along with the appointment of a Chapter 7 trustee. The Chapter 7 trustee reviews a borrower's estate to determine if there are any assets to distribute to creditors. After a Chapter 7 trustee investigates a borrower's estate and distributes assets, if any, a borrower will receive a Chapter 7 discharge.

Upon the entry of a Chapter 7 discharge, all debts listed in a borrower's bankruptcy schedules are discharged. Creditors are thereafter barred from seeking payment related to any discharged debts. If, during the course of a case, a borrower and creditor determine that debt reaffirmation is agreeable, there are strict time deadlines for the filing and approval of those agreements. If a borrower and creditor determine that they wish to enter into a loan modification agreement, without a formal reaffirmation agreement after a bankruptcy discharge, they may do so, but if there is a subsequent default, the borrower will not be personally liable for the underlying, modified debt.

### *Chapter 13*

In a Chapter 13 bankruptcy case, a borrower often seeks to retain all of his/her significant possessions with a debt repayment plan. Upon the filing of Chapter 13, a Chapter 13 trustee is appointed to disburse payments to creditors. Early in a Chapter 13 case, borrowers will file a Chapter 13 plan, which outlines her/her repayment plan and restructuring of debt. After review by creditors, the Chapter 13 trustee and the bankruptcy court, a Chapter 13 plan is "confirmed" and payments will start to creditors.

Regarding mortgage payments, in some districts a Chapter 13 trustee will disburse monthly mortgage payments along with an arrearage payment. In other districts, a borrower is responsible for ongoing monthly mortgage payments with the Chapter 13 trustee disbursing arrearage payments. In either district, a proof of claim should be filed in a timely manner by mortgage lenders and/or servicers. There are specific bankruptcy rules that outline the requirements for proofs of claims related to debts secured by a borrower's principal residence. Occasionally, mortgage servicers acquire loan portfolios from other mortgage servicers. If a loan is transferred from one mortgage servicer to another, a transfer of proof of claim should be filed with the

bankruptcy court. This allows the court, borrower and Chapter 13 trustee to know where to send payments and where to provide proper notice. If a borrower's monthly payment is scheduled to change, servicers should file a timely notice of payment change with the bankruptcy court, or the servicer will waive its right to collect any increase in mortgage payments. At the conclusion of the borrower's repayment plan, which is typically between three to five years, a borrower will receive a Chapter 13 discharge. All debts that were treated and paid pursuant to the borrower's confirmed Chapter 13 plan are thereafter discharged. Creditors are prohibited from seeking payment on any such debts post-discharge.

### *Chapter 11*

A Chapter 11 bankruptcy is often selected by high wealth individuals or companies for reorganization of debts. Similar to a Chapter 13 case, a Chapter 11 borrower must also file a Chapter 11 plan, which outlines the restructuring and repayment of debt. Creditors must analyze the proposed Chapter 11 plan and object in a timely manner if the creditor disagrees with the proposed treatment of its claim.

Bankruptcy issues can often be complicated and may require consultation with a bankruptcy attorney. Baker Donelson has attorneys with significant bankruptcy experience in each of our offices.