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SURVEY OF SELECTED BANKRUPTCY ISSUES
APPLICABLE TO HOMEOWNERS ASSOCIATIONS

DISCLAIMER

The information provided in this survey of bankruptcy issues is for informational purposes only. It does not constitute legal advice and should not be relied upon when making decisions regarding specific matters involving bankruptcy. The complexity of the Bankruptcy statute does not permit a comprehensive examination of the subject in such a brief format. Each matter must be evaluated individually to take into account the subtleties of the law. An attorney should be consulted regarding the specific details of any matter to obtain the appropriate counsel as to how any particular matter should be handled.

BANKRUPTCY BASICS

1. The most important thing to know about bankruptcy is once you receive notice that an owner has filed bankruptcy,
 - i) **Do not contact the owner about paying money (or demanding they take action that costs money) for any reason** without making sure you are following the rules of bankruptcy.
 - ii) **Do not take any action that penalizes an owner for any reason** without making sure you are following the rules of bankruptcy.

If you are not sure, don't do it!

2. There are no honest mistakes. If you improperly communicate with a person in bankruptcy, you will be liable if you are sued.
3. There are three types of bankruptcies you may come across. Chapter 7, 11 & 13.

Chapter 11 is rare for associations to be involved because it only involves persons or companies with debt that is well over a million dollars. If you receive a notice regarding an owner being in a Chapter 11 bankruptcy, forward it to the association's attorney.
4. There are significant differences between a Chapter 7 bankruptcy and a Chapter 13 bankruptcy.
 - i) A Chapter 13 is designed for an owner to pay delinquent assessments over five years;
 - ii) A Chapter 7 is designed for an owner to give their home back to the mortgage company and no longer be responsible for their assessment debt.
5. Chapter 13 is by far the most common type of bankruptcy that associations deal with. The majority of Chapter 13 bankruptcies are not successfully completed.
6. A bankruptcy only addresses the assessments due at the time the bankruptcy is filed, but the prohibition against trying to collect from an owner applies to all amounts due whether they came due before or after the bankruptcy was filed.
7. Once a bankruptcy is completed, there are no limitations on collection efforts for debt that continues to be due after the bankruptcy. Determining what debt continues to be due can be complicated.
8. Because of the many variations involved, we advise that the law firm deal with (or provide input) on all aspects of collections when an owner is in bankruptcy.
9. There are usually exceptions to any rule in bankruptcy.

CHAPTER 13 BANKRUPTCY

A Chapter 13 bankruptcy allows the owner to create a payment plan to be paid through the bankruptcy trustee to pay back an assessment delinquency over 60 months.

The Plan:

1. The court controls approval of the payment plan and the trustee administers the plan. It normally takes about four to six months for a plan to be approved. The trustee will begin making payments once the plan is approved.
2. If an owner fails to follow the plan, the court will dismiss their bankruptcy. However, the court is very forgiving in allowing persons in bankruptcy to cure failures to pay timely under their plan. A person in bankruptcy may get many months behind in their plan before the case will be dismissed.
3. When an owner successfully completes their bankruptcy plan, they have fully satisfied their obligation to the association up to the date that the bankruptcy was filed (sometimes plans will be amended during the bankruptcy to add in additional assessments that come due after the bankruptcy is filed).
4. Payments made by the trustee must be applied to the account as provided in the bankruptcy plan.
5. When an owner successfully completes their bankruptcy plan they receive a discharge. If they are not successful, their case is dismissed.

If a Chapter 13 Bankruptcy is dismissed, collections may resume as if the bankruptcy never occurred.

Lien Stripping:

1. If total amount that an owner owes on their mortgage, plus any delinquent property taxes, is greater than the value of their home, the owner's plan may remove the assessment lien from their home. This is called lien stripping.
2. When an owner strips the association's assessment lien, they are only responsible to pay the association pennies on the dollar that is due.
3. The lien strip does not effect assessments that come due after the filing of the bankruptcy.

Post Bankruptcy Accounting:

When an owner successfully completes a Chapter 13 bankruptcy, there will normally need to be adjustments made to their account.

CHAPTER 7 BANKRUPTCY

In a Chapter 7 an owner has two options, they either:

- i) pay their assessment debt in full directly to the association (not through the bankruptcy trustee); or
- ii) they surrender their home to satisfy all of the debts on the property. A surrender by law literally constitutes payment of the owner's personal obligation (but it does not extinguish the lien).

A Chapter 7 bankruptcy usually lasts less than one year.

Payment:

An association may enter into a payment plan directly with an owner in Chapter 7 to bring their account current. However, the owner must initiate the request for the payment plan. The association may not make demand for payment.

Surrender:

1. When a property is surrendered in a Chapter 7, there is almost always a mortgage that is also being satisfied by the surrender (and sometimes property taxes as well). This usually means the mortgage company will foreclose and the association will not receive any money.
2. Despite the surrender, owners sometimes work something out with their mortgage company. This creates a very difficult situation for the association since these agreements are private and the association does not have a reliable way to learn that they have occurred. When this does happen it is only the passage of time without a mortgage foreclosure that provides the indication that the owner and the mortgage company have worked out a deal.
3. If the owner and the mortgage company have worked out a resolution, the association's remedy is to begin the foreclosure process and see if the owner wants to work out a deal with the association.
4. When trying to work out an agreement with an owner after surrender you may not send a demand letter to the owner, as the personal obligation has been satisfied. Specific language limited only to the lien on the property must be used in any communication with the owner. These communications should all come from the association's attorney.

COLLECTING NEW ASSESSMENTS FROM OWNERS WHILE IN BANKRUPTCY

I. SENDING STATEMENTS FOR NEW ANNUAL ASSESSMENTS

When a new assessment is about to come due on a property that is currently subject to a bankruptcy, you should send a statement that is limited to just the new assessment. No past due balances should appear on the statement.

The statement should clearly indicate that it is limited to the new assessment and is not a statement of all amounts that may be due to the Association (there are some exceptions to this rule, but in order to make your job manageable, the only workable policy is to have a rule that you can follow reliably in every instance).

It is permissible and common to send a letter to the owner's bankruptcy attorney regarding post-petition delinquencies in Chapter 13 cases. It is not appropriate to make demand for payment to the attorney, since it is not their debt. Such letters are usually sent by the associations attorney.

II. MOTIONS FOR RELIEF FROM STAY

The only way to pursue collection of post-petition debts using normal non-bankruptcy collection steps is for the association to file a Motion for Relief from Stay with the bankruptcy court and have the judge sign an order permitting the association to collect in the accustomed way.

An association has more latitude to try to enforce deed restriction violations because they usually do not constitute a lien, and they can be enforced without demanding the payment of money. However, the association would still need to obtain a Motion for Relief from Stay before it could sue to obtain an injunction or recover any costs associated with the deed restriction enforcement.

A Motion for Relief from Stay will not necessarily be granted. One of the tests for whether a Motion for Relief is granted is an evaluation of whether the creditor is adequately protected by the collateral. This means, does the house have sufficient value to protect the association so that it is assured of being paid eventually, even if the recovery is delayed by the bankruptcy. The answer to the question will vary on a case by case basis.

When a person is in bankruptcy, you cannot recover legal fees for work done in the bankruptcy case without an order from the Court. Pursuing a Motion for Relief from Stay requires significant documentation and sometimes two appearances in court. Bankruptcy courts limit their award of fees for Motions for Relief to \$500.00, plus filing fees. It is very difficult to do all of the work required to obtain a Motion for Relief for \$500.00 in attorney fees. Therefore, an association must be willing to incur fees that it knows it will have to write off if it wants to pursue a Motion for Relief from Stay.

Due to the extra cost and uncertainty of success associated with Motions for Relief from Stay, our office does not pursue this option unless specifically requested by the client. In those cases, the circumstances of the particular file will be the primary consideration as to whether it makes sense to do so.

COLLECTION OF DELINQUENT ASSESSMENTS AFTER BANKRUPTCY

Unsuccessful Bankruptcy (Dismissed)

Chapter 13

When a Chapter 13 bankruptcy is dismissed collection efforts can resume as if the bankruptcy never occurred and all amounts accrued to the account at any time are due.

Chapter 7

Chapter 7 bankruptcies are almost never dismissed because the owner is not responsible to pay any money to complete the bankruptcy.

Successfully Completed Bankruptcy (Discharged)

Chapter 13

1. Chapter 13 Bankruptcies that are discharged bring the owner's account current through the date the bankruptcy was originally filed.
2. If an owner obtains a discharge in a Chapter 13 bankruptcy and they paid all assessments that came due after filing bankruptcy on time, their account balance upon exiting bankruptcy is zero.
3. You may use the normal non-bankruptcy collection procedures to collect unpaid assessments and interest, late fees, administrative charges and legal fees related to those assessments that came due after the bankruptcy was filed. You may not collect any interest, late fees, administrative costs or legal fees that were charged after the bankruptcy was filed, but that are related to the delinquent assessments that existed at the time the bankruptcy was filed.

Chapter 7

If delinquent assessments exist following the completion of a Chapter 7 bankruptcy, the association may enforce the lien by proceeding with foreclosure upon the property. The personal obligation of the owner has been satisfied by the bankruptcy and demand for payment may not be made to the owner to pay the personal obligation.

ENFORCEMENT OF RESTRICTION VIOLATIONS IN BANKRUPTCY

1. Deed restriction enforcement is the same whether a person is in Chapter 13 or Chapter 7 Bankruptcy.
2. You may provide notice of a violation and request that it be cured. You may not demand that it be cured, threaten a lawsuit, or demand payment of any amount of money.
3. If an association is going to legally enforce a restriction violation matter it must either
 - i) file a suit in the bankruptcy court (prior to such a suit, the association counsel will communicate with the owner's bankruptcy attorney in an effort to resolve the matter); or
 - ii) File a Motion for Relief from Stay and obtain the bankruptcy court's permission to sue in State court.
4. An association may follow self-help procedures that are permitted by their governing documents, except that it may not make demand for payment of the charges associated with the self-help action.

ENFORCEMENT OF RESTRICTION VIOLATIONS AFTER BANKRUPTCY

After an owner's bankruptcy is over, all restriction violation enforcement may proceed as normal (there may need to be adjustment to the owners account if restriction enforcement charges existed on the account at the time the bankruptcy was filed).