Altitude
Community Law

Bankruptcy And Its Effect On Collecting Association Assesments

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AN OVERVIEW

These materials concern themselves mainly with the effect of a bankruptcy on a homeowner association's ability to collect its assessments. Put another way, the object of these materials is to acquaint association managers and Board Members with the skills that will be necessary to determine whether a delinquent debt will still be collectible after a bankruptcy has been filed.

WHAT IS BANKRUPTCY?

Bankruptcy is a means by which a person (which can be an individual, partnership or corporation) seeks relief from debt. If a bankruptcy is successful, a person is no longer responsible under the law for the payment of debt. There are exceptions to that rule and the purpose of this article is to show you what they are and how they apply to homeowner association assessments.

The bankruptcy laws come from a long tradition of allowing persons freedom from debt. In biblical times, some persons freely forgave debt every seven years. After the American Revolution, when the Constitution of the United States was formed, the drafters gave Congress the power "...to establish...uniform Laws on the subject of Bankruptcies throughout the United States." Since the founding of the Nation, the right to seek debt relief through bankruptcy was considered to be a Constitutional right.

The bankruptcy laws are federal laws and are found primarily in Title 11 of the United States Code, though the criminal provisions and the provisions related to the judiciary, judicial rules and rules of evidence are found elsewhere. Title 11 is called the bankruptcy code which, together with the bankruptcy rules, are the principal source of law for consumer and business bankruptcies.

Many cases involving bankruptcy state that the bankruptcy laws were designed to give debt relief to the honest but unfortunate debtor; someone who has tried hard but failed, and whose only hope is to get a fresh start. The fresh start comes in the form of what is known as a discharge of indebtedness. As we shall see, modern bankruptcies are sometimes filed by persons who are anything but honest and unfortunate. An understanding of the intricacies of bankruptcy by creditors is frequently the only defense to the widespread abuses in the system.

HOW OFTEN CAN SOMEONE FILE BANKRUPTCY?

One of the most frequently misunderstood things about bankruptcy is the question of how frequently a person can file. The answer is, unless precluded by court order, a person can literally file a bankruptcy every day! Often debtors will file multiple bankruptcies. Frequently bankruptcies are dismissed then re-filed. There are, as well, serial bankruptcies where several related debtors file one bankruptcy after another. But the commonly misunderstood notion that someone can only file bankruptcy every seven years isn't true. The truth is there must be eight years between discharges under Chapter 7 or Chapter 11. Additionally, in Chapter 13 cases, discharge is not available to a debtor that received a discharge in a Chapter 7 or 11 bankruptcy filed within four years prior to the current Chapter 13. Further, a Chapter 13 debtor cannot receive a new discharge in a new Chapter 13 case filed within 2 years prior to the new Chapter 13 petition.

SOME BASIC BANKRUPTCY TERMS

The problem that most people have when dealing with bankruptcies is that it has a language all its own. Like any area of art or science, the words at first seem strange until they are understood. Here are some essential words you need to remember in dealing with bankruptcies:

<u>Debtor.</u> The debtor is the one who files the bankruptcy. A debtor can be an individual, like a homeowner, a consumer, a business, a partnership, a corporation, a city or county, but not a bank or trust.

<u>Creditor.</u> A creditor is a person or entity (e.g. a homeowners association) that is owed money by the debtor. There are two types of creditors: secured creditors and unsecured creditors.

<u>Estate or Bankruptcy Estate.</u> When a debtor files bankruptcy, an estate or a bankruptcy estate is immediately created. The estate consists of all of the debtor's assets (e.g. residence or unit) and all of the debtor's debts at the time the bankruptcy is filed. Think of the bankruptcy estate as a bankruptcy table. The debtor takes his assets (money, house, car, etc.) and puts them on the table. He takes all his bills and puts them on the table too. That is the bankruptcy estate.

<u>Trustee.</u> Except in a Chapter 11 bankruptcy, and sometimes even then, every bankruptcy results in the appointment of a trustee. The trustee assumes responsibility for using whatever assets exist to pay whatever debt exists, and for making sure that the debtor's bankruptcy papers are in order. The trustee then takes charge of everything that's on the bankruptcy table.

<u>Exemptions.</u> The law allows that when a debtor gets a fresh start, the debtor is allowed to take certain assets back from the bankruptcy table. Those assets which the debtor is allowed to take back are called exempt assets. The debtor gets them back by claiming exemptions. When the exempt assets go back to the debtor, they are taken off the bankruptcy table and the usual result is that all that is left is debt.

When a debtor files a bankruptcy, whether an association will be able to collect its money after the bankruptcy rests on:

1. Whether the association is a secured creditor;
2. Whether the debtor exempts and continues to occupy the property in an association community; and
3. What these two things mean from a legal point of view.

DOES EVERY BANKRUPTCY MEAN AN AUTOMATIC BAD DEBT?

Even though a person files bankruptcy, the association may still be able to collect past due assessments. What you know, and what you do about it, will make the difference between recovering and not recovering the debt.

These materials are designed to give board members, association managers and accounting support staff some rudimentary knowledge of bankruptcies in an assessment collection context. However, in the last analysis, bankruptcy law is still law. Managers and accounting staff, however skilled and knowledgeable, should not practice law without a license. So, while we will identify what you can do when faced with a bankruptcy, the best advice that anyone would give is to encourage you to seek timely legal advice from an attorney when a homeowner files bankruptcy, whether it is a Chapter 7 or a Chapter 13.

There are several reasons for this advice. First, the assistance of legal counsel can be obtained for a nominal amount of money. Second, legal counsel will have a far greater grasp of the significance of small details in a bankruptcy which might be lost on someone else. Third, legal counsel will be very skillful in avoiding an inadvertent violation of bankruptcy law, which can have very serious economic consequences. And finally, the legal practitioner takes the community manager or leader off the hot seat when it comes to deciding the best course of action in face of a bankruptcy.

TYPES OF BANKRUPTCIES

There are several types of bankruptcies, which are identified both by what they do and by the chapter in which they are found in the Bankruptcy Code. Some types are ones that you will probably never encounter, like a farmer or a municipality. The types you will encounter include the following:

Chapter 7: Liquidation. The Chapter 7 bankruptcy is referred to in the Bankruptcy Code as being a "liquidation." The idea is that the debtor's assets are sold to pay the debtor's debts (the money the debtor owes to creditors). Sometimes that actually happens. Most often it does not, because when the debtor's exempt property is taken off the "bankruptcy table", there is nothing left to liquidate (that is, to sell) to generate the money to pay the debt. The end result is that in a Chapter 7 bankruptcy, the bankruptcy discharge wipes out all of the debtor's pre-petition debt: The creditors get nothing unless, as shown below, the creditor is secured.

Chapter 11: Reorganization. The Chapter 11 bankruptcy is referred to as a reorganization and sometimes a business reorganization. When it was originally designed, it was designed for large businesses to get what is known as a breathing space to give them time to offer a plan to repay all or part of their money to their creditors, so that they could continue business as a reorganized debtor. The availability of the Chapter 11 was extended to individuals. Because there were certain limitations on qualifying for a Chapter 13 bankruptcy (one could only have so much assets and so much secured and unsecured debt), the Chapter 11 became a popular vehicle for individual debtors in areas where property values (and so mortgages) went up beyond the Chapter 13 debt limits.

Chapter 13: Wage Earner Plan. The Chapter 13 bankruptcy is sometimes referred to as a wage earner plan. It gives the debtor who has a regular income the opportunity to pay his creditors. Before Chapter 13 was added to the Bankruptcy Act, debtors who wanted to do that had to file under the very cumbersome Chapter 11. The Chapter 13 bankruptcy is considerably more simple and user friendly, but still more complex (and more expensive) than filing a Chapter 7 bankruptcy. It allows debtors to pay all of their creditors all of the money owed, some of the money owed, or none to some and some to others. The Chapter 13 bankruptcy may also be utilized by small businesses. Understanding how a Chapter 13 bankruptcy can affect a community association, or, more importantly, how a community association can affect a Chapter 13 bankruptcy, is some of the most important information you can derive from this outline.

BANKRUPTCY REFORM ACT OF 2005 (BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT (BAPCPA)

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 was signed into law on April 20, 2005. The law mandated the most comprehensive overhaul of the nation's bankruptcy rules in more than 25 years. Community association claimed a significant victory with the passage of this law. Previously, the bankruptcy rules stated that post-petition community association fees (and specifically, only residential condominiums and residential cooperatives) were not dischargeable if the owner resided in or rented out the unit. Homeowner associations, time-share condominiums and commercial condominiums were excluded. But many owners abandoned their units and argued that they did not have to pay post-petition fees due to the loophole language. Many courts interpreted the language to include all common interest ownership communities and as such, if the owner abandoned the property, those post-petition fees would be discharged in the bankruptcy in many cases.

The victory for community associations was the language in 11 U.S.C. 523(a)(16), which clarified the obligation to pay post-petition fees. The new language linked the obligation to pay to ownership of the unit, rather than occupancy. The liability to pay post-petition fees continues "for as long as the debtor or the trustee has a legal, equitable, or possessory ownership interest" in the unit.

Another major reform of the Act was an increase in the responsibilities of individuals seeking liquidation. Chapter 7 filings are typically undertaken by persons who have little to no equity in any assets and who have mostly unsecured debt. The Act now provides that the debtor demonstrate that there is no reasonable alternative to the bankruptcy process. The debtor must prove an inability to pay debts as they are due and must also demonstrate a good-faith attempt to resolve the debts without the protection from the bankruptcy.

In order to help implement this good-faith demonstration, the Act created a "means test" for eligibility to file for Chapter 7 liquidation. The means test requires a comparison of the debtor's income to the median income in the individual's domiciled state. If the debtor's income is above the median and he is able to pay at least a minimal amount per month to creditors, then the owner will not be able to file a Chapter 7 bankruptcy.

Chapter 7 debtors must also go through debt counseling and provide proof to the court that same has been completed.

COMMENCEMENT OF A BANKRUPTCY CASE

A bankruptcy case begins with the filing of a petition. A "petition" is a request. In the bankruptcy petition, the debtor requests that the court give him or her relief under the Bankruptcy Act.

Upon filing of a petition, the court immediately and automatically issues an order for relief. Among other things, the standard order for relief "stays" (or stops) creditors from pursuing their claims. That means creditors cannot continue to call the debtor, write the debtor, ask for payment, lien the debtor's property, sue the debtor in court, take judgments against the debtor, issue writs of execution against the debtor, levy execution against the debtor's personal property, foreclose and sell the debtor's house, or otherwise take any action to collect on a debt. Because the order for relief is a stay and because it is automatic, it is often referred to as the "automatic stay."

Along with the petition, the debtor files several things. In every bankruptcy, the debtor files what are known as schedules, which consist of schedules "A" through "J". Additionally, in every bankruptcy, the debtor files a Statement of Affairs. This consists of answers to certain questions which present the debtor's financial picture just prior to the filing of the bankruptcy, and show, for example, if the debtor was being sued, or if the debtor's house was being foreclosed upon by somebody. In every case, the debtor files a budget (income/expenses: it is part of the schedules) showing the debtor's inability to pay debts as they fall due. Neither the budget nor the Statement of Affairs are critical to a bankruptcy analysis for a homeowner association debt.

In Chapter 7 and Chapter 11 bankruptcies, the debtor files a document called a Statement of Intentions. The statement of intentions is supposed to state what the debtor intends to do with property to which there is secured debt. Frequently, the statement of intentions reveals whether a debtor intends to keep and retain or surrender real property in a community association development. The statement of intentions can frequently be the key document in determining the impact of a Chapter 7 (and possibly a Chapter 11) bankruptcy.

In a Chapter 13 (wage earner repayment plan), there is no Statement of Intentions which is required, though it is sometimes filed, because a Chapter 13 debtor files a plan shortly after the filing of a bankruptcy. This shows how the debtor plans to repay the debtor's creditors. In a Chapter 13 bankruptcy filing, the debtor's debt, as of the date of filing, must be included in the owner's reorganization plan. In most Chapter 13 filings, debtors are seeking to retain their property and simply reorganize their payments to creditors over a longer period of time (three to five years). If a debtor is retaining his property, the association's interest is simple: the debt as of the date of filing is secured by the association's lien on the property and must be included in the plan. If the debtor fails to include the association for the proper amount owed and as a secured creditor, the association has the right to file a Proof of Claim to correct the amount included in the plan, and if the debtor fails to correct the plan, the association can object to the confirmation of the plan. Until the association is properly included, the bankruptcy court should not approve the debtor's plan.

If the debtor properly includes the association, but the debtor fails to pay post-petition assessments, the association has the right to dismiss the bankruptcy. Because Chapter 13 bankruptcies are more complex (and therefore, more expensive), debtors will typically make arrangements to cure the post-petition default so that the bankruptcy remains in effect. Debtors in Chapter 13 bankruptcies can give up (abandon) property, but rarely do. A Chapter 13 bankruptcy represents the best chance for an association to collect its money.

In the event that an owner is surrendering the property in a Chapter 13 bankruptcy, what is the effect on the association? That's when things get tricky for an association. In a typical Chapter 13 filing, where the property is being surrendered, the debtor is going to obtain a "normal" discharge, which will treat the association as a general unsecured creditor for pre-petition debt and discharge the post-petition debt (just like the pre-petition debt in a Chapter 7 bankruptcy). This is not a good situation for the association because it typically leaves the association unpaid for an indefinite amount of time (until the bank takes over the property after a foreclosure).

A few courts have found that the covenant to pay association dues is not contractual, but rather is a covenant running with the land. As such, those courts have found that the debtor's personal liability for the dues is an incidence of ownership of the property not affected by the filing of the bankruptcy. This should mean that the post-petition debt would not be dischargeable. However, the statute is clear that in a normal discharge, post-petition assessments are dischargeable, and therefore, not the responsibility of the debtor.

PRE-PETITION AND POST-PETITION

As shown, the filing of a petition creates an automatic stay. It places all of the debtor's debt, and all of the debtor's assets on the bankruptcy table. The petition date is a critical time for both the debtor and for creditors. It is important to understand what the filing of a petition does in terms of debts and assets.

Everything that happens before the petition is filed is pre-petition. Everything that happens after the petition is filed is post-petition. Understanding what pre-petition and post-petition means is one of the most important aspects of bankruptcy analysis.

Pre and Post-Petition: Analysis

The debtor lives in the Happy Homeowners Association and the dues are due on the first of every month in the amount of $100. The debtor has failed to make monthly assessment payments for many months and files bankruptcy on September 10, 2012. The Declaration provides that assessments are delinquent fifteen days after the due date and that the Association may assess a late fee of $15 on late payments upon a delinquency. When the debtor files on September 10, 2012, the debtor has missed ten payments, including September 1, 2012. The debtor has missed $1,000 in assessment payments and late fees for nine months (not ten, since the 15th has not arrived). The delinquency totals $1,000 plus 9 x $15 or $1,135. Those are the debtor's pre-petition arrearages. (For purposes of this example, we have omitted any reference to interest, however, interest would be handled the same as late fees.)

Remember: Everything that happens before the filing of a bankruptcy is pre-petition. Everything that happens after is post-petition. As we shall see, this distinction becomes significant for two reasons: First, in most cases (see Chapter 13, surrendering property exception), the post-petition assessments are non-dischargeable and are not affected by the bankruptcy. Second, to the extent that the association has secured itself with a recorded lien, the pre-petition assessments are still collectible from the property itself. This is the key to a homeowner association surviving a bankruptcy.

THE PETITION, SCHEDULES, STATEMENTS AND PLAN: WHAT'S IMPORTANT

When a debtor files a bankruptcy, he/she files about forty pages of paper with the court. Contained within these papers are: the petition, the schedules, the statement of affairs, the plan (in Chapter 13's) and (in Chapter 7's and 11's) the statement of intentions. Sometimes all of these documents are not contained in the original filing. Debtors are permitted to file an emergency petition, which consists only of the petition and the list of creditors. This type of petition is called an emergency petition or a face sheet petition, because it consists of just enough to get the order for relief and the automatic stay. When a debtor files a face sheet petition, the debtor is given a short period of time to file the remaining papers with the court.

Let's review what is in each of the papers the debtor files:

The Petition: The petition shows the name of the debtor, the court, the bankruptcy number, the name of the debtor's attorney, and other data relating to the number of creditors, the amount of assets and the amount of debt. The petition also shows the chapter of the bankruptcy, the date the bankruptcy was filed, the date of the creditor's hearing and whether or not the debtor has filed complete or incomplete papers with the court. The petition, when filed, creates a stay. The stay lasts until the bankruptcy concludes with a discharge of indebtedness, the bankruptcy is dismissed, or relief from stay is granted by the court.

Schedules: Which are Important? Following the petition you will find the schedules, which are lettered "A" through "J". The schedules list all of the debtor's property and all of the debtor's debt by category. These schedules show what the debtor owns and what the debtor owes.

Which Schedules are Important to an Association? In the beginning of this outline, we pointed out that there were two questions that were critical to a bankruptcy in a community association development. Those two questions were: (1) Is the association secured? and (2) Does the debtor intend to leave or stay in the property? Keep those questions in mind right now.

The important portions of a debtor's Chapter 7 or 11 filing to an association are: Schedule A, Schedule C, and Statement of Intentions.

Schedule A: This is the debtor's schedule of real property. It shows what the debtor's real property is worth and what is owed. Schedule A shows whether there is equity in the debtor's property. This has a direct bearing on whether the debtor will leave (abandon or surrender) the property or stay (exempt) the property. Since the bankruptcy reform act was enacted, in a Chapter 7 or 11 filing, whether the debtor intends to surrender or retain the property is less important. What this schedule will tell you is whether you should be monitoring the property for foreclosure activity (yes, if the owner’s statement of intention indicates a surrender of the property).

Schedule C: This is the property the debtor claims is exempt. The debtor puts all the property (assets) on the table but is allowed to take some back for a fresh start. That is exempt property. Debtor's frequently claim an exemption for their personal residence. This is usually an indication that the debtor intends to stay with the property. If the association is a secured creditor, the association will probably be able to collect all of its assessments even though the debtor has been through bankruptcy. This is because the lien on the property is not affected by the bankruptcy. The bankruptcy will only discharge the owner’s personal obligation for the pre-petition debt, but does not affect the encumbrances on the property.

Statement of Intentions: The debtor is supposed to state whether he or she intends to retain the real property or walk away from it (abandon it). In the first part, the debtor has the opportunity to state that he or she will surrender the residence and in the second part the debtor has the opportunity to state that he or she will retain the property and pay the debt that attaches to the property in favor of secured creditors. The Statement of Intentions usually tells you everything. But since there is disagreement among bankruptcy lawyers as to the type of debt that belongs on a Statement of Intentions, sometimes the residence is entirely excluded. That is why looking to the relative equity, and whether or not the debtor is exempting the property, is helpful too.

The Chapter 13 Plan: What to Look For. As stated above, Chapter 13 debtors file schedules, so you can look at them and see the equity in the property (Schedule A) and whether the debtor is claiming an exemption for the property (Schedule C), but you will not know if the debtor intends to surrender or retain the property unless the debtor gratuitously files a Statement of Intentions (which sometimes happens, but rarely). Consequently, knowing what is going to happen for your association in a Chapter 13 usually depends upon looking at the plan. The plan shows three things: (1) what category of creditor your association is proposed to be, (2) whether or not the debtor agrees to make post-petition assessment payments as they fall due, and (3) whether or not the debtor intends to abandon the property in your association. We will go through a Chapter 13 plan at length later in this outline.

Anyone can obtain copies of the petition, schedules, and plans that have been filed by going to the Bankruptcy Court, located in downtown Denver, and checking out the file.

FINDING OUT A BANKRUPTCY HAS BEEN COMMENCED

What is a Meeting of Creditors?

The only way for a lay person to get answers in a bankruptcy context without running the risk of the unauthorized practice of law is to attend the meeting of creditors.

The petition and the notice of commencement of case show the date, time and place of the meeting of creditors.

A meeting of creditors is a mandatory hearing, outside the bankruptcy court, conducted by the trustee, where usually a group of debtors are assembled, and where they are briefly examined one by one by the trustee as to the matters set forth in the papers they filed to commence their bankruptcy. Creditors are free to attend a meeting of creditors, though frequently they do not, primarily because there are usually a large volume of cases and there is little time to ask questions. But creditors have a right to make limited inquiry of debtors at the meeting of creditors. And, importantly, there is no requirement that a creditor's representative be an attorney. Consequently, association managers and board members may attend the creditors' meeting, and when their homeowner's case is called they can step forward and briefly inquire of the debtor (who is testifying under penalty of perjury) exactly what the debtor intends to do with the property located in a community association development and whether or not the debtor intends to pay the association any assessments for past or future debt!

Consequently, while an attorney can tell what will happen in a bankruptcy and render an opinion and course of action for an association without leaving his office, a lay person cannot do this. But the lay person can attend the meeting of creditors and ask the debtor and the debtor's attorney directly - and answers will usually be direct and forthcoming. While this is not a substitute for sound legal analysis, it is an answer to the dilemma when an association does not hire legal counsel to monitor bankruptcies.

If You Missed the Meeting of Creditors

Even if you missed the meeting of creditors in a certain case, you can still write directly to a debtor's attorney to request the debtor's intention relative to property in a community association development and continued assessment payment. Additionally, the Bankruptcy Rules allow any creditor to examine a debtor under oath as to virtually anything relevant to the bankruptcy. But only an attorney could accomplish that for you, and it would be far cheaper to simply have the attorney analyze the bankruptcy in the first place.

TYPES OF CREDITORS AND TYPES OF DEBT

The Central Issue in Homeowner Bankruptcy

With some limitations not pertinent here, creditors are either secured or unsecured. A secured creditor is one who has obtained the right to sell or repossess property to satisfy a debtor's debt to that creditor. For example, when one buys a car and takes a loan to do so, usually the lender takes a security interest in the vehicle. This gives the lender the right to take the vehicle back if the payments are not made. The lender can then re-sell the vehicle to get some or all of the loan money back. Likewise, some retailers selling goods on credit take what is known as a purchase money security interest in the goods that are sold. Again, this gives them the right to take the goods back if the payments are not made.

Most homeowner associations have recorded declarations of covenants, conditions and restrictions, which give the homeowner association the right to require owners in the community to pay money to the association. These documents, as well as provisions of the law, usually give the association certain rights in the event that an owner does not pay. Among the typical rights given is the right to record a lien against the owner's property for unpaid assessments. Additionally, associations in Colorado have a "statutory" lien against the property for all unpaid assessments, late fees, fines, interest, attorney fees and costs. Colorado's Common Interest Ownership Act ("CCIOA") provides that association have this "statutory" lien and that recording a lien with the county is not necessary.

Note that recording the assessment lien serves as notice to third parties that the property is encumbered by a debt for delinquent assessments and other charges. Recording a paper lien is always recommended.

Because of the association's lien, the association then has the right to sell the property to collect the unpaid debt. The lien is then a security interest. The debt to the association is secured. The association is, therefore, a secured creditor.

Remember that the object of most bankruptcies is to get a discharge. The discharge frees the debtor from any personal liability for debt. The debtor cannot be compelled or even asked to reach into his pocket and pay the debt.

But, with some limited exception (addressed at the end of this outline) a bankruptcy discharge cannot and does not affect a secured creditor's right to proceed to sell the property to which it has a lien. If a creditor has secured itself with a valid lien, the creditor can sell the property liened to satisfy its debt. In a homeowner association context this means that if the association has recorded a lien against property in its community and the owner files bankruptcy, the association can still sell the property to satisfy the entire obligation to the association, whether it arose before or after the bankruptcy was filed. This action would occur through a judicial foreclosure action of the association's lien.

At this point you may be able to see why the two questions involved in homeowner bankruptcies are so important. If the association protects itself with a lien, it will in most cases not be affected by the bankruptcy, provided the debtor keeps the property. This is because despite the bankruptcy, the association will still be able to compel payment by foreclosure. However, if the debtor abandons the property, the likelihood is that a mortgage holder senior to the association would foreclose itself, consequently wiping out the association's lien.

Regardless of the type of bankruptcy, the best case scenario for an association is to have the debtor decide to keep the property. Debtors keep the property in more than half of the Chapter 7 cases and in about ninety percent of the Chapter 13 cases.

Remember: Because the association is a secured creditor (unless the property has already gone through foreclosure) and the debtor keeps the property, the association can proceed with a foreclosure despite a bankruptcy.

DISMISSAL, DISCHARGE, RELIEF FROM STAY

When Can a Creditor Proceed?

The association has a foreclosure pending against certain property pursuant to a recorded lien. The debtor files bankruptcy. Legal counsel has determined from a review of the debtor's Schedule C (exemptions) and the debtor's Statement of Intentions that the debtor has claimed a homestead exemption for the property and intends to retain the property, or a board member or community manger has gone to the meeting of creditors, asked the debtor, and the debtor said that is what he or she intended to do. During the bankruptcy, the debtor did not make any payments. The association wants to continue with its foreclosure to force the issue.

When Can it Make the Next Move?

Remember: A bankruptcy petition is a request for relief. The order for relief creates an automatic stay. The automatic stay stops creditors from proceeding on their claims.

So When Does the Automatic Stay End?

There are three ways for an automatic stay to end.

1. If the bankruptcy is dismissed. This happens from time to time when the debtor fails to attend the meeting of creditors or when the debtor fails to file all of the papers required to proceed.

2. When a creditor requests relief from stay. This is done by bringing a written motion in the bankruptcy court which requests that the judge lift the stay to allow a creditor to do certain things (i.e., foreclose on property, proceed with an eviction, etc.).

3. The most frequent way for the stay to end is when the debtor gets a discharge of indebtedness. The entry of the discharge lifts the automatic stay.

Of course, it means the order entered at the commencement of the case that stops creditors from proceeding on their claims is no longer in effect. But does that mean that a creditor is then free to do anything to collect a debt? No, because the automatic stay is replaced by a new order, called a discharge injunction. The discharge injunction forbids creditors from attempting to collect debts that were discharged through the bankruptcy.

What Debt is Discharged? The Unsecured Debt

With limited exception, secured debt is not affected by the discharge. That is because the secured creditor continues to have a lien against the debtor's property. And even though the debtor cannot be compelled to pay the debt, the property can be sold to do so. And usually that results in the debt being paid.

BRIEF REVIEW

Generally, there are two types of creditors and debt: Secured and unsecured. A secured creditor is one who has a lien on property, such as a recorded notice of delinquent assessment, or if not recorded, the association's "statutory" lien.

When a debtor files bankruptcy, an automatic stay comes into effect and remains in effect during the bankruptcy. In the case of a Chapter 7 bankruptcy, that is about six month's time. In the case of a Chapter 13 or 11, it can be many years. During the time the automatic stay is in effect, creditors are forbidden by court order from proceeding on their claims for pre-petition debts.

The bankruptcy stay ends when the bankruptcy is dismissed, when the court grants a creditor relief from stay, or when a discharge is entered at the close of a case.

The entry of a discharge prevents creditors from proceeding on unsecured debt claims. Secured creditors may commence or continue foreclosing upon the subject of their security interest after the discharge is entered. The discharge does not prevent them from doing that.

Dismissal and discharge are not the same. If a bankruptcy is dismissed, it is as though it was never there in the first place. Creditors can proceed against the debtor as to secured or unsecured claims. There is no discharge of indebtedness. When a bankruptcy is discharged, unsecured creditors are forever barred from proceeding. Secured creditors may proceed against their collateral.

How to Determine Dismissal or Discharge

Since even an inadvertent violation of the automatic stay can have serious consequences, the wisest choice is to have an attorney determine whether the association can proceed on its claims. Otherwise, there are several ways to find out.

First, creditors receiving the notice of commencement of case will ordinarily also receive notification if a bankruptcy is dismissed or discharged. This does not always happen. Second, creditors can file a request for notice in the bankruptcy, and serve a copy on the debtor's attorney. This request for notice requires that the creditor be informed of any development in the bankruptcy case. Third, creditors can go to the bankruptcy court and look at the file. The bankruptcy court in Colorado has user friendly computer terminals which show the index of things happening in a case. In the court system, this index is called a docket. And finally, anyone with a computer and an internet connection (and a little money to spend) can sign on to a federally sponsored program called P.A.C.E.R., which gives on-line access to the dockets of every federal court in the country.

Regardless of the method that is utilized, the entry of a dismissal or discharge ends the bankruptcy. If the association was secured and the debtor keeps the property, the association is in the best position to collect its debt. When either a discharge or dismissal is entered, the association may proceed.

WHEN ARE ASSESSMENTS NON-DISCHARGEABLE?

Prior to 2005, the Bankruptcy Act provided that certain homeowner assessments were not discharged in a bankruptcy. The applicable provision stated that where an owner continued to occupy property in a condominium association after filing a bankruptcy, or where the owner rents that property, that the assessments are non-dischargeable. This generally meant that where a debtor keeps the property in an association, the association may proceed against the property for assessments arising before and after the bankruptcy, and may proceed against the debtor personally for assessments arising after the bankruptcy.

In 2005, when the bankruptcy reform act was passed, the language in 11 U.S.C. 523(a)(16) was clarified regarding the obligation to pay post-petition fees. The new language linked the obligation to pay to ownership of the unit, rather than occupancy. The liability to pay post-petition fees continues "for as long as the debtor or the trustee has a legal, equitable, or possessory ownership interest" in the unit.

HANDLING THE CHAPTER 7 BANKRUPTCY

Chapter 7 bankruptcies are liquidations. The object is debt relief. To commence a Chapter 7, the debtor files a petition. At the same time, or shortly thereafter, the debtor files Schedules, a Statement of Intentions, a Statement of Affairs, and a list of creditors. The petition shows the date of filing, the name and social security number of the debtor, the name and address of the attorney (if any) for the debtor, and the date and time of the meeting of creditors. The Schedules show all of the debtor's property, debt, exemptions, income and expenses. The Statement of Affairs shows the debtor's financial position (i.e., lawsuits, etc.) as of the time of the bankruptcy filing. The Statement of Intentions is supposed to show (but does not always show) whether the debtor is going to retain or surrender property to which secured debt attaches.

Chapter 7 bankruptcies last about six to nine months from filing to discharge unless the bankruptcy is dismissed. About a week after the debtor files a petition and the other required papers, a notice of commencement of case is sent to all of the creditors listed on the creditor's list by the bankruptcy court. This notice gives the same information that is found on the petition and also states the date, time and location of the meeting of creditors.

When a bankruptcy is filed, you should always determine if the debtor is going to keep the property. If the debtor claims an exemption for the property on Schedule C, or indicates that he or she will retain the property on the Statement of Intentions, the likelihood is that the debtor will be keeping the property, and that the association will be free to proceed against the property as to all assessments, and against the debtor as to post bankruptcy assessments, when the case concludes. The case concludes when it is dismissed or discharged.

You can also determine the debtor's intentions by asking the debtor at the creditors' meeting or by writing the debtor's attorney. If the debtor states that he or she will keep the property, and the association had a pre-petition lien, the association may foreclose after the bankruptcy if the assessment remains unpaid.

If, on the other hand, the debtor's Statement of Intentions states that the debtor will surrender the property, the likelihood is that the assessment debt will become a bad debt because a lienholder senior to the association will probably foreclose itself after the bankruptcy is over. This will eliminate the association's lien and so its security interest. In that case, the pre-petition debt will not be collectable. However, the debtor will remain responsible for the post-petition debt until he/she no longer has an ownership interest in the property (i.e., the property sells at foreclosure, in most cases).

HANDLING THE CHAPTER 13 BANKRUPTCY

Chapter 13 bankruptcies are designed to allow a debtor to pay some or all of his or her creditors. Chapter 13 bankruptcies may be filed by anyone with a regular income (it is sometimes referred to as a Wage Earner's bankruptcy). Chapter 13 bankruptcies can last anywhere from two to five years (they most often last five years).

In many ways, Chapter 13 bankruptcies start out the same as Chapter 7's. But there are significant differences as well. The Chapter debtor files a petition and gets a stay order, just like the Chapter 7 debtor. The Chapter 13 debtor also files Schedules, a Statement of Affairs and a list of creditors. However, unless the debtor's attorney just happens to include it, the Chapter 13 debtor does not file a Statement of Intentions. So, there is not a handy document to look at to determine whether a debtor is going to keep or surrender property.

Within a short period of time after a Chapter 13 bankruptcy is filed, the debtor also files and mails to creditors a document called a Chapter 13 plan. This may be the first document a creditor receives notifying the creditor of the Chapter 13 filing. It sometimes comes before the Notice of Commencement of Case, and sometimes it comes after. Sometimes, due to inadvertence in mailing, it is never received at all, and a creditor has to access it at the courthouse.

A Chapter 13 plan tells what the debtor intends to do to pay back his creditors. It ranks the creditors according to their interests. It may provide for full payment or for partial payment. It may provide for the payment of interest. Since a Chapter 13 debtor, like a Chapter 7 debtor, gets a discharge at the conclusion of the bankruptcy (sometimes years after the filing), the Chapter 13 plan can, and frequently does, provide that unsecured creditors are paid a portion of what they are owed, and the debtor gets a discharge as to the rest.

But, like the Chapter 7 bankruptcy, with limited exception, which we will discuss later, the Chapter 13 debtor can do little with secured debt and creditors, other than to pay it. That is why the critical inquiry, again, becomes: Is the association secured and is the association treated as secured in the plan? This is frequently the only inquiry, since ordinarily the debtor intends to keep the property in the association community. Chapter 13 bankruptcies are almost always filed to save real property from foreclosure.

The plan will show the amount of money the debtor is going to pay toward the debts and how long the bankruptcy will go on. The plan also lists classes of creditors. Class 1 consists of creditors entitled to priority over all other creditors. These usually include the Chapter 13 Trustee, the debtor's attorney, and the taxing authority. Sometimes the Class 1 numbers can be quite high, and this is usually attributable to tax debt, which is the second most common reason why debtors file Chapter 13's (behind trying to save the residence from foreclosure).

Class 2, 3 and 4 are all derivations of creditors who the debtor acknowledges are holding secured creditor status. The first, second and other mortgage holders will be seen in Class 2. Usually, a homeowner's association will be there too. Next to the names are the amounts which the debtor claims he or she owes the creditor, and the amount of monthly money that will go to pay that creditor's debt once the class of creditors is reached (since the Class 1 creditors will always be paid first). The debtor should state the plan for paying post-petition debts.

Two things tell you at once what is going on, and they are either on page two or three of the plan. If the debtor acknowledges the homeowner association's secured status by listing the association for payment in Class 2, 3 or 4, then the issue of the secured status is resolved. The plan will provide for payment in full of the association's claim. But that is not the end of the inquiry. Look to the right of the association's name and ask yourself: Is the amount claimed by the debtor the same as the amount the debtor owes? It almost always is not. Debtors tend to estimate and they hardly ever estimate high. Also, the amount stated may not include late fees, interest accrued to the time of the filing of the bankruptcy, other charges, and attorney fees (if incurred). In such a case, unless the association files a proof of claim or formal objection to the plan, the association will likely be stuck with the debtor's number. That is why it is always advisable to file a proof of claim.

The proof of claim form is a fairly simple document. It usually arrives at the same time as the Notice of Commencement of Case. The Notice of Commencement of Case comes at about the same time in relation to a Chapter 13 bankruptcy as it does with a Chapter 7. The information contained on the notice is about the same also, with one significant difference: The meeting of creditors in a Chapter 13 case is usually followed (sometimes the same day) by a hearing in the bankruptcy court. This hearing is for the purpose of determining whether a debtor's Chapter 13 plan should be approved or disapproved. A Chapter 13 debtor may not do whatever he or she pleases. Plans can be approved and plans can be disapproved also.

There are several ways that a Chapter 13 plan can be disapproved. One rather obvious one is where the debtor fails to show up for the meeting of creditors or the plan confirmation hearing. That usually results in dismissal of the case. Another way is if the plan is impractical, for example, if the debtor owes enormous sums of money but makes little by comparison.

And finally, a plan can be disapproved if a creditor objects. It is a fact that a Chapter 13 payment plan can be disapproved (and frequently is disapproved) due to the objection of one secured creditor.

The Importance of Being a Secured Creditor

If the debtor does not provide for payment in full plus interest, plus monthly payments after the bankruptcy as they fall due, the association's attorney can object to the confirmation of the plan. The usual result is that the debtor amends the plan and gives you what you want--secured creditor treatment and payment in full.

When the court approves a debtor's Chapter 13 plan it is said to have been confirmed. Once a Chapter 13 plan is confirmed, the debtor goes on to perform the plan. In addition to providing for the debtor's creditors, the plan should provide for the payment of post-petition assessments as they fall due. If not, the association has grounds for an objection or to file a motion with the court to have the debtor's bankruptcy dismissed.

The debtor performs the Chapter 13 plan by paying a specified sum every month to the Chapter 13 trustee, who then pays claims based upon the terms of the plan. Every secured creditor should prepare and file a proof of claim for the full amount owed. The proof of claim form is relatively simple and straightforward. Filing the claim means that either the trustee will pay it or the debtor will have to object to it.

Over a period of years the debtor in a Chapter 13 then pays the trustee and the trustee pays the creditors. Provided you have filed a proof of claim and the Chapter 13 succeeds, you will likely get paid. The money does not always come right away, though, since other creditors may be in front of you under the plan.

In addition to paying the trustee monthly, a Chapter 13 debtor ordinarily must pay all post-petition payments as they fall due to certain creditors. The purpose of the Chapter 13 bankruptcy is only to pay pre-petition debt. Consequently, the association should be getting payment on the assessments after the bankruptcy on time and when they fall due.

Many associations set up a pre-petition and a post-petition account. The pre-petition account is held in suspense until the conclusion of the bankruptcy. Payments from the trustee are credited to that account. The post-petition account then starts over with a zero balance, and bills can be sent to the debtor as to this account. There are a variety of ways to handle the pre- and post-petition accounts. None are better or worse than any other, so long as they result in a method that assures that the trustee payments will be credited to the pre-bankruptcy balance and assures further that the association will have a method of determining if the debtor fails to make payments on a regular basis after the bankruptcy is filed.

What Happens if the Debtor Does Not Pay?

If the debtor does not pay the trustee, the likelihood is that the case will either be converted to a Chapter 7, in which case you will run the analysis set up in the preceding section, or the case will be dismissed. Dismissal for failure to make the plan payments is quite common. If you have utilized one of the methods to be aware of a dismissal, which we detailed earlier, you will know when it happens. Remember, a dismissal is the same as the bankruptcy never being there.

The debtor then pays the trustee for the pre-petition debt or usually suffers a dismissal. What if the debtor does not pay the association? This, by the way, is no small matter in a Chapter 13, since it can go on for years. Many times associations do not do anything when their Chapter 13 debtors do not pay post-petition assessments. The result is an assessment debt many thousands of dollars greater than it would have been.

If a debtor fails to make timely post-petition payments, an association should promptly notify legal counsel. Legal counsel can notify the owner or if represented, the owner's attorney, regarding the unpaid post-petition assessment payments. If the post-petition balance is not brought current, then legal counsel can file a motion with the court to have the bankruptcy dismissed. Very frequently, when a motion to dismiss the debtor's bankruptcy is filed, the debtor will come to an agreement with the association to cure the post-petition arrears. In exchange for that, a knowledgeable attorney will attempt to procure what is known as an adequate protection order, in which the manner by which the default is cured is specified and the association is granted dismissal if the debtor fails to make payments timely again.

The other option is to authorize legal counsel to seek relief from stay. Relief from stay is a motion presented to the court, to let the association free of the stay. Free to do what? Free to foreclose on the debtor's property. The grounds for granting such a motion exist if the creditor is not adequately protected. The concept of adequate protection simply means that the creditor is being paid on time after the filing of the bankruptcy. Otherwise, adequate protection does not exist and grounds for relief from stay do.

If association legal counsel brings a relief from stay motion after a post-petition default, one of two things will happen. Either the association will get relief from stay or, in a manner of speaking, the debtor will "come clean." Again, very frequently, the latter of these two things is the result. Debtors then come to an agreement with the association to cure the post-petition arrears. In exchange for that, a knowledgeable attorney will attempt to procure what is known as an adequate protection order, in which the manner by which the default is cured is specified and the association is granted relief from stay automatically if the debtor fails to make payments timely again.

In the event that an owner is surrendering the property in a Chapter 13 bankruptcy, what is the effect on the association? That's when things get tricky for an association. In a typical Chapter 13 filing, where the property is being surrendered, the debtor is going to obtain a "normal" discharge, which will treat the association as a general unsecured creditor for pre-petition debt and discharge the post-petition debt (just like the pre-petition debt in a Chapter 7 bankruptcy). This is not a good situation for the association because it typically leaves the association unpaid for an indefinite amount of time (until the bank takes over the property after a foreclosure).

A few courts have found that the covenant to pay association dues is not contractual, but rather is a covenant running with the land. As such, those courts have found that the debtor's personal liability for the dues is an incidence of ownership of the property not affected by the filing of the bankruptcy. This should mean that the post-petition debt would not be dischargeable. However, the statute is clear that in a normal discharge, post-petition assessments are dischargeable, and therefore, not the responsibility of the debtor.

Review

In a Chapter 13 bankruptcy, the debtor plans on paying some or all of what is owed to his or her creditors.

The Chapter 13 debtor files most of the same papers as a Chapter 7 debtor, but does not file a Statement of Intentions.

The Chapter 13 debtor mails a plan to his or her creditors.

Homeowner associations should be listed as Class 2, 3 or 4 creditors. Payment in full should be provided for in the plan. The amount stated as owed by the debtor should be checked against the association's records. Payment in full should be provided for in the plan. The amount stated as owed by the debtor should be checked against the association's records for accuracy.

At or about the time the plan is circulated, creditors will receive a Notice of Commencement of Case. The notice is virtually identical to a Chapter 7, but says "Chapter 13." It shows the date and time of the meeting of creditors but it also shows the date and time for the hearing to confirm the plan.

Chapter 13 plans are not automatically approved. Creditors can object. A plan can be defeated by the objection of one secured creditor. Associations should always object to inadequate plans.

Creditors can attend the meeting of creditors in a Chapter 13 bankruptcy to ask limited, pertinent questions. Lay persons are welcome and frequently do attend.

In a Chapter 13 bankruptcy the important thing is to make sure the association is listed as secured, that the debtor provides for payment in full, and that the plan provides for continued payment of post-petition assessments as they fall due.

Always file a proof of claim. A lay person may lawfully sign a proof of claim as "agent", but that person is then responsible for the accuracy of the claim. It is recommended that legal counsel prepare the proof of claim for filing with the court.

If a debtor's Chapter 13 plan is confirmed, the pre-petition debt is paid to the trustee monthly who then distributes to creditors according to their rank in the plan.

Debtors are responsible for paying post-petition association assessment payments directly to the association as they fall due.

Association managers or legal counsel should periodically check on Chapter 13 bankruptcies to see if a significant development has occurred, such as conversion, dismissal, or relief from stay granted to a mortgage holder on the property in the association's community.

The object in a Chapter 13 bankruptcy is to monitor payment. Pre-petition money comes from the trustee. Post-petition payments come from the debtor. Segregating the accounts is helpful if not vital.

If the debtor fails to pay the trustee, you will likely know of it when the case is dismissed.

If the debtor fails to pay post-petition assessments, the remedy is to seek either a dismissal or relief from stay. Frequently, this makes the debtor "come clean", and pay the post-petition arrears. Legal counsel can get a stipulation for adequate protection to allow automatic relief from stay if the problem arises again.

If the debtor is surrendering the property in a Chapter 13 bankruptcy, the association will become an unsecured creditor. This means that it is unlikely that the association will receive any pre-petition payments. It also means that the debtor will likely obtain a discharge of the post-petition debt.

CHAPTER 11 BANKRUPTCIES

Chapter 11 of the Bankruptcy Code allows those not qualifying for Chapter 13 to reorganize. Associations will see these types of bankruptcies where the debtors owe large amounts of secured or unsecured debts, or do not have ordinary income. One interesting Chapter 11 bankruptcy was where a homeowner won the lottery, then overspent and had to file a Chapter 11 to buy time to the next installment on his millions!

Chapter 11 bankruptcies can be extremely complex. They are subject to a number of rules and engender enormous amounts of paper. Associations should probably always have competent legal counsel handle these types of bankruptcies. Having said that, we will point out that these types of bankruptcies are similar in many ways to others. The debtor files the same papers initially as in Chapter 7. One can access those documents and get the same information. There is a Notice of Commencement of Case that has the same information as the same notice under any other chapter. There is a meeting of creditors and creditors may attend and ask brief questions. The principal difference is that the debtor has time in which to present a plan and a disclosure statement, the latter of these being a ponderous tome which purports to explain the plan. Frequently, the plan and disclosure statement come many months after the filing of the bankruptcy.

Nevertheless, there are certain things that must be done. A claim must be filed in every case. The case should be monitored to make sure post-petition payments are timely made. Otherwise, relief from stay should be sought. When the plan and disclosure statement come, someone should read them to determine what class of creditors the association falls into and how the debtor intends to pay. Since creditors vote on Chapter 11 plans, this analysis is essential to determine whether or not to vote for the plan.

UNSECURED CLAIMS AND BAR DATES

The entire discussion has concerned itself with making sure an association is secured. But what if the bankruptcy occurs after the association's security interest is lost to a senior lender? This happens from time to time. Sometimes, a debtor will lose the property, but later will file a bankruptcy. If the bankruptcy is a Chapter 7, the association is faced with a bad debt because, as we have shown, the unsecured debt will be discharged in the Chapter 7. But if the debtor files a Chapter 13 bankruptcy and provides for payment of all or part of the money owed to unsecured creditors, the association may still recover some money if and only if it timely files an unsecured proof of claim.

If the association does not timely file an unsecured claim in such an instance, it will get nothing from the Chapter 13 plan.

Consequently, even though the association's debtor has been foreclosed and moved out of the community, all Chapter 13 plans should be reviewed to determine whether or not they provide for payment to unsecured creditors. They are usually listed as Class 5. If payment is provided for unsecured creditors, only a timely filed proof of claim will be paid. The Notice of Commencement of Case, right under the information about the debtor, trustee, attorney, etc., will have the bar date. It will say: "Final date for filing proofs of claim is (date)." File the claim by that date, for sure. The date is called a bar date for a reason. Failure to file the claim is an absolute bar to payment.

MULTIPLE BANKRUPTCIES

Debtors may legitimately file more than one bankruptcy. It is not the filing of the bankruptcy but the obtaining of the discharge which is limited. Frequently a debtor will file a Chapter 7 bankruptcy and be discharged from all unsecured debt. Then, the same debtor will file a Chapter 13 bankruptcy and propose a plan of payment for that debtor's secured creditors, or tax debt not discharged in the Chapter 7 bankruptcy. Conversely, a Chapter 13 bankruptcy could fail and be dismissed and this would not prevent the debtor from then filing a Chapter 7, or for that matter another Chapter 13 bankruptcy. Association managers and board members should be aware that just because a bankruptcy has been dismissed or discharged does not mean there cannot or will not be another one. Always be on the alert. The most frequent violation of the bankruptcy stay occurs when one fails to recognize a re-filing when it occurs.

Debtors can be precluded from re-filing a bankruptcy for some period of time. Usually it is specified on the face of the dismissal. Usually it is for a period of one hundred eighty days. This is called a 109g refiling preclusion, after the Bankruptcy Rule upon which it is based. Debtors can be precluded from filing bankruptcies for greater periods of time, but it is rare.

CONCLUSION

The primary purpose of this article has been to help the association managers and board members become conversant in bankruptcy as it relates to assessment collection. That question always concerns itself with situating the association in the best position to get paid. It does not always work, but it is always worth the effort. Where legal counsel is employed in this process, the other twists, turns and things that can happen in a bankruptcy context will be his problem. Most bankruptcies are routine and follow a predictable path. Sometimes you win, sometimes you do not. Knowing what is happening makes the difference.

If you encounter any situation which is strange to you (especially a threat of action by a debtor), you should seek prompt legal assistance. There are many things which can occur in a bankruptcy that are clearly beyond the scope of these materials.