California Homeowner Bill of Rights COLLABORATIVE

National Housing Law Project
Western Center on Law & Poverty
National Consumer Law Center
Tenants Together

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Note to readers:

June 30 is the last day of funding for our grant from the Office of the Attorney General of California. Starting July 1, 2015, we will no longer be able to continue the level of services we offered in the last two years to consumer attorneys, including technical assistance, litigation support, monthly newsletters, and regular updates to the web site, until we receive additional funding. We appreciate all your work on behalf of homeowners and tenants in California, and please continue to use our existing materials for your work.

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Dealing with Fallout from a Borrower's Past Bankruptcy in Foreclosure Litigation[1]

I. Introduction

For homeowners who have endured long-term problems with mortgage lenders, filing a lawsuit may be only the latest in a series of actions they have taken to save their homes. Sometimes those past actions included the filing of a petition for bankruptcy relief. In certain instances the homeowners may have filed a bankruptcy petition as part of a carefully planned strategy to preserve homeownership. In other cases they may have discharged unsecured debts so they could focus on dealing with their major secured debt, the mortgage loan. Still other homeowners may have tried bankruptcy out of desperation, believing they had no alternatives for gaining time to explore other options. For any number of reasons, bankruptcy may not have produced a long-term solution. Now the homeowner wants to explore a lawsuit against the lender or servicer.

With increasing frequency, advocates find themselves considering litigation on behalf of clients who come to their offices with some bankruptcy history. The fallout from a past bankruptcy can present real problems in litigation against a lender or servicer. Attorneys who represent these creditors routinely try to use homeowners' past bankruptcies against them. Fortunately, there are ways to prepare for these challenges and minimize their impact. This article will address the most common bankruptcy fallout issues in foreclosure litigation and suggest how best to deal with them.

Three Recent California Examples

Three recent California appellate decisions addressed the most common bankruptcy fallout scenarios. In the first case the homeowner filed a lawsuit in state court raising contract and tort causes of action against his mortgage servicer. He asserted strong claims that his servicer had acted improperly in failing to convert his trial loan

[1] This article was written by John Rao, attorney at the National Consumer Law Center.

modification to a permanent modification. However, shortly after he filed the case, the homeowner learned that he did not "own" his own lawsuit. Instead, the lawsuit belonged to the trustee in an old chapter 7 bankruptcy case that he had filed years earlier. The bankruptcy case had been closed long ago, after the homeowner received his discharge of debts. The bankruptcy trustee, who the court now considered to be the owner of the lawsuit, had only one interest: to settle the case for as much money as possible and use those funds to pay off the creditors in the old bankruptcy case. The homeowner would receive no relief under the trustee's proposed settlement. The bankruptcy court approved the settlement, and the Ninth Circuit Bankruptcy Appellate Panel affirmed that this was as a proper outcome.[2]

In the second case, a borrower filed a lawsuit alleging that his servicer had engaged in dual tracking when it foreclosed while he was being reviewed for a loan modification. This borrower had never received a discharge in a prior bankruptcy case. However, he had filed chapter 13 cases twice while pursuing the modification. Both bankruptcy cases had been dismissed. Although the borrower listed the deed of trust debt in his bankruptcy schedules, he had not included any legal claim against his servicer in the list of his personal property filed with the bankruptcy court. According to the trial court deciding the post-bankruptcy lawsuit, this borrower had taken an inconsistent position in not listing the legal claim against his servicer as an asset in his bankruptcy schedules. Now, he could not file a lawsuit later in which he asserted that he had such a claim. The U.S. district court held that taking these "inconsistent" positions called for the application of judicial estoppel. The court dismissed the borrower's lawsuit with prejudice.[3]

In the third case, the borrower sued a lender and servicer after a foreclosure sale. The borrower alleged that these defendants conducted the sale without authority because they relied on faulty loan document transfers. In a prior bankruptcy case the borrower had challenged the

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[2] *In re* Goldstein, 526 B.R. 13 (B.A.P. 9th Cir. 2015).
[3] Swendsen v. Ocwen Loan Servicing, LLC, 2014 WL 1155794 (E.D. Cal. Mar. 21, 2014).

rights of the same parties to file a bankruptcy proof of claim. The bankruptcy court allowed the proof of claim. The state court dismissed the borrower's post-bankruptcy lawsuit. According to the state court, the dispute over the creditors' proof of claim in bankruptcy court was a proceeding entitled to res judicata treatment. This borrower could not proceed with a lawsuit challenging the same parties' authority to foreclose after the bankruptcy court had allowed the parties' proof of claim. The California Court of Appeal upheld the trial court's dismissal of the complaint on claim and issue preclusion grounds.[4]

These cases illustrate three common bankruptcy fallout problems: lack of standing, judicial estoppel, and res judicata. Defense counsel in a wide range of cases are becoming more aggressive about bringing these challenges. They often succeed in having otherwise meritorious lawsuits dismissed over what appear to be trivial mistakes in old and forgotten bankruptcy schedules. Given that over a million individuals file for consumer bankruptcy relief yearly, these defense tactics can have a wide and pernicious impact. The effect is particularly harsh for borrowers involved in foreclosures. Many borrowers could not afford to pay an attorney to pursue legal claims extensively in bankruptcy. The economics of consumer bankruptcy practices often do not lead to thorough review of all the debtor's potential legal claims. When a homeowner's advocate is pursuing litigation years later, the harm from the past bankruptcy activity has already occurred. Nevertheless, there are ways for advocates to minimize the impact of these harsh creditor remedies.

II. Whose Lawsuit is this? The Problem of Standing after Bankruptcy

1. Standing <u>in</u> bankruptcy – what should happen?

Before we address the homeowner's ability to bring certain lawsuits *after* bankruptcy, it is important to understand what should have happened while the homeowner was in bankruptcy. Because the

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[4] Boyce v. T.D. Service Co., 235 Cal. App. 4th 429 (2015).

rules for chapter 7 and chapter 13 cases are different, we will first discuss bankruptcy standing in the context of chapter 7. By "in bankruptcy" we mean the period of time from the filing of the initial chapter 7 petition for relief up until the bankruptcy case is closed out.[5]

When an individual files any bankruptcy petition, the property that the person owns at the time of filing becomes property of a bankruptcy estate.[6] The Bankruptcy Code defines property of the bankruptcy estate broadly. The estate encompasses any lawsuits in which the debtor is currently a plaintiff. It also includes legal claims and causes of action that the debtor could bring, but has not yet filed. Prepetition legal claims not exempted by the debtor may be administered and liquidated by the trustee.[7] The chapter 7 trustee, not the debtor, has exclusive standing to pursue any cause of action that is property of the estate.[8] The trustee has the right to litigate, settle, or sell the legal claim for the benefit of creditors.

There are two ways for the debtor to gain control over a pre-bankruptcy legal claim and pursue it while in bankruptcy. One way is to exempt the legal claim. In order to claim an exemption, the debtor must list the legal claim as an item of personal property of the debtor (Schedule B, Line 21) and give it an estimated or "unknown" value. On Schedule C the debtor must designate an available exemption for the legal claim. If no one objects, the exemption is allowed and the debtor has standing to pursue the claim as its legal owner.[9]

Alternatively, the cause of action listed on the debtor's schedules may be "abandoned" by the trustee. Abandonment in a bankruptcy case occurs in one of two ways: (1) if, on request by the trustee or a party in interest and after notice and hearing, the court finds that the

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[5] Note that the "closing" of the case is not synonymous with the date upon which the discharge order is granted. After the discharge enters, the bankruptcy clerk's office will close the case pursuant to § 350(a) and Fed. R. Bankr. P. 5009. Ideally this will be only a short time after the discharge has entered. However, in some cases it could take longer.
[6] 11 U.S.C. § 541(a)(1).
[7] 11 U.S.C. § 704(a)(1).
[8] 11 U.S.C. § 323.
[9] 11 U.S.C. § 522(l); Cusano v. Klein, 264 F.3d 936 (9th Cir. 2001); *In re* Adair, 253 B.R. 85 (B.A.P. 9th Cir. 2000).

property is "burdensome" or of "inconsequential value and benefit to the estate"[10]; or (2) automatically when the bankruptcy case is closed.[11] Thus, the debtor has the choice of either seeking formal abandonment of the scheduled legal claim by filing a motion while the bankruptcy case is open,[12] or simply waiting until the case is closed. After the bankruptcy case has been closed, the debtor may pursue any lawsuit that was listed in the bankruptcy schedules and not liquidated by the trustee.[13]

Exemption or abandonment are two ways through which a pre-bankruptcy legal claim ceases to be part of the chapter 7 bankruptcy estate and becomes the debtor's property. However, neither option can occur if the debtor did not list the pre-petition legal claim as an asset in the bankruptcy schedules. It is this "scheduling" of the asset that allows the trustee to make an informed decision about whether to "administer" (i.e., liquidate) the legal claim. The trustee cannot administer an undisclosed asset.[14]

2. *What happens if the debtor does not schedule a pre-bankruptcy legal claim?*

The post-bankruptcy "standing" problem typically appears when a debtor did not mention a pre-bankruptcy legal claim in his or her schedules. This omission could have occurred for a number of reasons. The debtor's bankruptcy counsel may not have asked clearly about

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[10] 11 U.S.C. § 554(b).
[11] 11 U.S.C. § 554(c).
[12] *See, e.g.,* Radford v. U.S. Bank Nat'l Ass'n, 2011 WL 4054863 (D. Haw. Sept. 9, 2011) (bankruptcy court's order approving trustee's request for abandonment gives debtor standing to pursue TILA and other prebankruptcy claims in district court during pendency of bankruptcy).
[13] *See e.g.* Just Film, Inc. v. Merchant Servs., Inc. 873 F. Supp. 2d 1171, 1176 (N.D. Cal. 2012) (abandonment as a matter of law at closing of case under § 554(c) gives borrower standing to pursue scheduled cause of action).
[14] Typically the "scheduling" will include a description of the cause of action in the listing of the debtor's personal property (Schedule B, Official Form 6B, Item 21: "Other contingent and unliquidated claims of every nature including tax refunds, counterclaims of the debtor, and rights to setoff claims"), an appropriate exemption claimed on Schedule C (Official Form 6C), and, if applicable, reference to a pending lawsuit in the Schedule of Financial Affairs (Official Form 7, Item 4: "Suits and administrative proceedings" to which debtor was a party within one year immediately preceding the filing of the bankruptcy case).

possible legal claims. The debtor may have told counsel generally about certain lender communications or documents, but neither the debtor nor counsel examined the facts closely enough to realize that they supported a legal claim. Bankruptcy counsel providing a fixed-fee chapter 7 representation may not have reviewed the debtor's entire mortgage loan file to assess whether the debtor had the right to bring consumer claims against a servicer or lender. These unexplored causes of action could include contract or tort claims, as well as violations of state unfair and deceptive practices statutes, state and federal debt collection laws, RESPA and TILA.

The consequences of leaving a legal claim unscheduled in a bankruptcy case can be severe, and often catch debtors and their advocates unawares. The crux of the problem is that when a pre-bankruptcy asset is unscheduled, it is never administered, exempted, or abandoned. Instead, if the bankruptcy case is closed after entry of a discharge, the unscheduled property remains part of the bankruptcy estate. It is not considered property of the debtor. Instead, it rests with the bankruptcy estate in a state of perpetual suspense.[15] As the representative of the bankruptcy estate, only the chapter 7 trustee, not the debtor, has standing to pursue the unscheduled legal claim after the bankruptcy case is closed.[16]

If the plaintiff now suing a lender or servicer filed for bankruptcy relief in the past, and if the events that were the basis for the current lawsuit occurred before the bankruptcy filing, defense counsel will likely check to see if the plaintiff identified the legal claims in the bankruptcy schedules. If the claims existed at the time of

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[15] 11 U.S.C. § 554(d); Tyler v. DH Capital Mgmt., Inc., 736 F.3d 455, 465 (6th Cir. 2013) (unscheduled debt collection claim was not "abandoned" and trustee retained exclusive authority to pursue it); Parker v. Wendy's Int'l, Inc., 365 F.3d 1268, 1272 (11th Cir. 2004) (failure to list an interest in bankruptcy schedules leaves that interest in the bankruptcy estate); *In re* Riazuddin, 363 B.R. 177 (B.A.P. 10th Cir. 2007). *But see* Crawford v. Franklin Credit Management Corp., 758 F.3d 473 (2d Cir. 2014), discussed note 22, below regarding effect of dismissal of bankruptcy cases without discharge.

[16] *See, e.g.,* Biesek v. Soo Line R Co., 440 F.3d 410 (7th Cir. 2006) (trustee, not debtor, is real party in interest to prosecute unscheduled prepetition claim); *In re* Riazuddin, 363 B.R. 177 (B.A.P. 10th Cir. 2007) (same).

the bankruptcy filing and the plaintiff did not disclose them, the defendant can move to dismiss the post-bankruptcy lawsuit. Many state and federal courts will grant the dismissal on the theory that the causes of action belong to the estate in the closed bankruptcy case and the individual homeowner-plaintiff lacks standing to enforce the claims. The courts have dismissed a variety of foreclosure-related lawsuits due to this bankruptcy standing problem,[17] including Truth-in-Lending[18] and other debt collection claims.[19] As an alternative to

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[17] *See In re* Edwards, 2011 WL 4485560 (B.A.P. 9th Cir. Aug. 26, 2011) (claims for wrongful foreclosure that occurred prebankruptcy belonged to bankruptcy estate, not debtor); *In re* Seymour, 2013 WL 1736471, at *5-6 (B.A.P. 9th Cir. Apr. 23, 2013) (unpublished) (debtor's unscheduled prepetition claims against mortgagee were property of the bankruptcy estate, doctrine of prudential standing precluded debtor from asserting trustee's rights); Aniban v. Indymac Bank, F.S.B., 2012 WL 292337 (D. Nev. Jan. 31, 2012) (*pro se* consumer's mortgage origination claims dismissed due to failure to schedule them in prior chapter 7 bankruptcy); Chanthavong v. Aurora Loan Servs., Inc., 448 B.R. 789 (E.D. Cal. 2011) (after bankruptcy court refused to reopen case and borrower's claim against mortgage servicer had not been scheduled or formally abandoned by trustee, borrower's post-bankruptcy lawsuit against servicer dismissed).

[18] Guerpo v. Amresco Residential Mortgage Corp., 13 F. App'x 649, 650 (9th Cir. 2010) (debtor's prepetition TILA rescission claims became part of the bankruptcy estate, debtor lacks standing to pursue them); *In re* McKenna, 2013 WL 2321936 (B.A.P. 9th Cir. May 28, 2013) (dismissing debtor's adversary proceeding, including TILA claims, where debtor failed to schedule or exempt claims and had no specific order for abandonment); *In re* Seymour, 2013 WL 1736471, at *5-6 (B.A.P. 9th Cir. Apr. 23, 2013) (debtor's unscheduled prepetition claims against mortgagee were property of the bankruptcy estate, doctrine of prudential standing precluded debtor from asserting trustee's rights); Davis v. U.S. Bank Nat'l Ass'n, 2012 WL 6619322, at *3 (C.D. Cal. Dec. 17, 2012) (dismissing unscheduled TILA claims as having accrued prepetition); Rivera v. Reconstrust Co., N.A., 2012 WL 2190710 (D. Nev. June 14, 2012) (dismissing plaintiff's TILA and loan origination claims because not scheduled in prior chapter 7 case); Krug v. Wells Fargo Bank, N.A., 2012 WL 1980860, at *5 n.2 (N.D. Cal. June 1, 2012) (dismissing TILA claim because it belonged to homeowner's bankruptcy estate); Hernandez v. Downey Sav. & Loan Ass'n, 2009 WL 704381 (S.D. Cal. Mar. 17, 2009) (denying bankruptcy debtor's motion for injunction based on TILA claim for lack of standing; claim belonged to estate); Runaj v. Wells Fargo Bank, 667 F. Supp. 2d 1199 (S.D. Cal. 2009) (dismisses TILA and HOEPA actions because debtor not real party in interest, but grants leave to amend to add trustee as proper plaintiff); Cobb v. Aurora Loan Servs., L.L.C., 408 B.R. 351 (E.D. Cal. 2009) (granting motion to dismiss TILA action because consumer plaintiff is not real party in interest); Hernandez v. Downey Sav. & Loan Ass'n, 2009 WL 704381 (S.D. Cal. Mar. 17, 2009) (dismissing TILA claims); Rowland v. Novus Fin. Corp., 949 F. Supp. 1447 (D. Haw. 1996) (absent showing that claim had been exempted or abandoned, consumer lacked standing to pursue TILA rescission action).

[19] Tyler v. DH Capital Mgmt., Inc., 736 F.3d 455 (6th Cir. 2013); Thompson v. Ocwen Fin. Corp., 2013 WL 4522504 (D. Conn. Aug. 27, 2013) (mortgage assignment that was predicate act for FDCPA claim occurred before bankruptcy filing; failure to

dismissal, the court may allow the bankruptcy trustee to prosecute and settle the lawsuit.[20]

3. How to respond to bankruptcy standing challenges

To begin with, advocates should check PACER records for every client before filing a foreclosure-related lawsuit in state or federal court. PACER records show past bankruptcy filings. If filings exist, the court records will indicate whether the legal claims were disclosed. It is always better to address potential bankruptcy standing problems before filing a lawsuit, rather than as a response to the defendant's summary judgment motion or motion to dismiss raising plaintiff's lack of standing. Regardless of when counsel finds out about the existence of the omission in the prior bankruptcy case, there are several points to consider.

Did the borrower actually disclose the claim? This will be evident from looking at Schedule B and the Schedule of Financial Affairs filed in the bankruptcy case, as well as any amendments to the initial schedules. In some cases counsel may be able to argue successfully that less than complete scheduling satisfied the basic disclosure requirement.[21] If the adequacy of a disclosure is doubtful, it is probably

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schedule debt collection claim in bankruptcy precluded consumer's standing to raise claim in later action); Griffith v. Javitch, Block & Rathbone, L.L.P., 358 B.R. 338 (S.D. Ohio 2007); *In re* Leslie, 2007 WL 80806 (Bankr. D. Conn. Jan. 5, 2007) (debtor lacked standing to assert claims which arose prior to the petition).

[20] *In re* Goldstein, 526 B.R. 13 (B.A.P. 9th Cir. 2015) (approving bankruptcy trustee's settlement of debtor's claims against mortgage servicer that included fraud in inducement, breach of contract, and promissory estoppel arising from failure to convert trial modification to permanent modification); *see also* Seneca v. First Franklin Fin. Corp., 2011 WL 3235647 (S.D. Cal. July 28, 2011) (dismissing borrower's loan origination claims, including TILA claims, that had not been scheduled in prior chapter 7 case, allowing time for substitution of trustee); Macias v. WMC Mortgage Corp., 2010 WL 114006 (S.D. Cal. Jan. 6, 2010) (dismissing debtor's TILA rescission action with leave to amend to substitute trustee or to show bankruptcy estate's exemption or abandonment of claim)

[21] *See e.g.* Eun Joo Lee v. Forster & Garbus, L.L.P., 926 F. Supp. 2d 482 (E.D.N.Y. 2013) (rejecting standing challenges where debtor disclosed FDCPA claim in bankruptcy schedules, even though one potential defendant's name omitted from description). *See also* note 54, *infra,* discussing completeness of scheduling in judicial estoppel context.

the best practice to treat this as a non-disclosure and amend the schedules, as discussed below.

Did the borrower's claims really accrue pre-petition? It must be kept in mind that the bankruptcy standing problem does not exist, at least for chapter 7 cases, if the borrower's claims arose *after* the filing of the initial petition for relief. Subject to exceptions inapplicable to mortgage issues, a legal claim acquired after the date of filing the chapter 7 petition does not belong to the bankruptcy estate. Occasionally a pattern of servicer misconduct straddles the pre- and post-petition time periods.[22] In these instances it will be to the borrower's advantage to characterize the critical events as occurring post-petition. Where there are multiple causes of action, certain claims may be post-petition, while others are pre-petition.

Was the prior bankruptcy case dismissed? While the Ninth Circuit has not addressed this issue, the Second Circuit recently held that the Code provision under which the bankruptcy estate retains unscheduled estate property does not apply to dismissed bankruptcy cases.[23] The closing of a bankruptcy without a discharge occurs

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[22] Mahoney v. Bank of Am., N.A., 2014 WL 2197068 (S.D. Cal. May 27, 2014) (rejecting standing challenge where negligent servicing continued before, during, and after bankruptcy petition filed); Malfatti v. Mortgage Elec. Registrations Sys., Inc. 2013 WL 3157868, at *5 (N.D. Cal. June 20, 2013) (borrower's foreclosure-related claims accrued post-petition and were not part of the bankruptcy estate); McDonald v. IndyMac Mortgage Servs., 2013 WL 2252105, at *4 (N.D. Cal. May 22, 2013), *on reconsideration,* 2013 WL 3491051 (N.D. Cal. July 11, 2013), and subsequent decision 2014 WL 3372983 (N.D. Cal. July 9, 2014) (examining borrower's standing to pursue various claims against mortgage lenders, including under FDCPA, RESPA, and TILA, based on whether claims accrued before or after bankruptcy filing, applying delayed discovery rule to allow standing for certain claims); Vang Chanthavong v. Aurora Loan Servs., Inc., 448 B.R. 789 (E.D. Cal. 2011) (dismissing certain claims on standing grounds, but lender did not show borrower's breach of contract loan modification claim accrued pre-petition (claim dismissed on other grounds); *see also* Hernandez v. Dyck-O'Neal, Inc., 2015 WL 2094263 (M.D. Fla. May 5, 2015) (refusing to dismiss FDCPA claims on standing grounds; claims involved improper deficiency action where foreclosure sale occurred pre-petition, but creditor filed deficiency lawsuit post-petition); *In re* Rhinesmith, 450 B.R. 630, 634-635 (Bankr. W.D. Tex. 2011) (all conduct related to FDCPA claim took place post-petition and had no roots in prepetition conduct, claim belonged to debtors and not chapter 7 trustee).

[23] Crawford v. Franklin Credit Mgmt. Corp., 758 F.3d 473 (2d Cir. 2014) (under §349(b)(3) of the Code property of the bankruptcy estate revests in the debtor upon dismissal of a case; § 554(d) with its provisions keeping unscheduled property in the estate applies only to the closing out of fully administered bankruptcy cases);

frequently in chapter 13 cases. However, chapter 7 cases are occasionally dismissed without a discharge as well. This happens, for example, if the debtor failed to file paperwork necessary to proceed to discharge and to the formal closing of a fully administered bankruptcy case.

Reopening a closed bankruptcy case and amending the schedules. This is the option counsel are most likely to consider when the legal claims clearly existed before the chapter 7 bankruptcy filing, the claims were omitted from schedules, and the debtor obtained a discharge. In this situation it is possible to reopen the closed bankruptcy case for the purpose of amending the schedules to add the omitted claims.[24] The bankruptcy court and the trustee have a duty to see that any asset of the estate disclosed for the first time after a case has been closed is administered.[25] In reopening the case, the debtor can seek to exempt the legal claim or have the trustee abandon any interest in it.[26]

Mackall v. JPMorgan Chase Bank, N.A. __ P.3d __, 2014 WL 4459624, at *2 (Colo. App. Sept. 11, 2014) ("where a bankruptcy case is dismissed, the Bankruptcy Code seems to unequivocally grant a debtor standing to assert any claim that it possessed before it filed for bankruptcy, regardless of whether it disclosed the claim to the bankruptcy court during the bankruptcy proceedings.").

[24] 11 U.S.C. § 350(b); *see In re* Narcisse, 2013 WL 1316706, at *5-6 (Bankr. E.D.N.Y. Mar. 29, 2013) ("cause" to reopen includes need to amend schedules to add asset or creditor); Schaefer v. First Source Advantage, L.L.C., 2013 WL 509001 (E.D. Mo. Feb. 12, 2013) (denying dismissal of debt collection claim on standing grounds where, after debt collector raised standing issue, debtor reopened bankruptcy case, scheduled claim, and obtained order of abandonment).

[25] *In re* Riazuddin, 363 B.R. 177 (B.A.P. 10th Cir. 2007) (pursuant to Code §§ 350(b) and 544(c), bankruptcy court has duty to reopen case upon prima facie evidence the case not fully administered; dismissal of lawsuit inappropriate); *In re* Lopez, 283 B.R. 22, 29 (B.A.P. 9th Cir. 2002) (even assuming debtors intentionally misled bankruptcy court in omitting claim from schedules, proper remedy is to reopen bankruptcy case and administer the claim as asset of estate); Edwards v. Wells Fargo Bank, N.A., 2013 WL 3467215 (C.D. Cal. July 9, 2013) (dismissal for lack of standing appropriate because plaintiff omitted wrongful foreclosure claim from prior chapter 7 schedules, but court allows plaintiff opportunity to take corrective action before making a dismissal effective); *In re* Arana, 456 B.R. 161 (Bankr. E.D.N.Y. 2011) (in determining whether to reopen bankruptcy case under 11 U.S.C. § 350(b) to allow scheduling of omitted claim court must give greatest weight to benefit creditors will derive from liquidation of the claim).

[26] Spaine v. Cmty. Contacts, Inc., 756 F.3d 542, 546 (7th Cir. 2014) (amendment of schedules and abandonment resolved post-bankruptcy standing problem).

In considering the reopening of a bankruptcy case, careful exemption planning is essential. The trustee may seek to liquidate any nonexempt property created by the litigation and distribute the proceeds for the benefit of creditors. Ultimately, once the schedule is amended the trustee decides whether to liquidate the claim for creditors or abandon the estate's interest in the claim. If the claim is abandoned or exempted, the debtor should then be free to pursue it.

There are strong arguments in favor of allowing reopening to amend schedules. To the extent that the claims are a valuable asset, the trustee can provide a benefit for creditors. To the extent that the claims are exempt or have insignificant value for creditors, the initial omission of the claims from bankruptcy schedules did not harm anyone. From a policy perspective reopening and amendment are preferable to use of the bankruptcy standing doctrine to allow the defendants in the post-bankruptcy lawsuit to walk away scot free.

Allowing the bankruptcy trustee to pursue the claims. If the bankruptcy case is reopened and exemption or abandonment do not restore a prebankruptcy legal claim the debtor, the trustee retains standing to assert the claim. If the lawsuit has already been filed, the trial court should allow the trustee to substitute in as plaintiff.[27] The trustee may, with court approval, hire the debtor's attorney to pursue the claim on behalf of the bankruptcy estate.[28] The bankruptcy court

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[27] Substitution or joinder of the trustee under Federal Rules of Civil Procedure 17(a), 25(c), or similar rules should accomplish this result. Flowers v. Wells Fargo Bank, N.A., 2011 WL 2748650 (N.D. Cal. July 13, 2011) (as alternative to dismissal of lawsuit against loan servicer for lack of standing, plaintiff ordered to substitute bankruptcy trustee or else show exemption or abandonment of claims); Runaj v. Wells Fargo Bank, 667 F. Supp. 2d 1199 (S.D. Cal. 2009) (dismissing TILA and HOEPA actions because debtor not real party in interest, but with leave to amend to substitute trustee under Rule 17). *See generally* Wieberg v. GTE Southwest, Inc., 272 F.3d 302 (5th Cir. 2001) (district court erred in dismissing civil action due to debtor's lack of standing without allowing time for bankruptcy trustee to be substituted as real party in interest under Rule 17).

[28] 11 U.S.C. § 327(e); Jordan v. Paul Fin., L.L.C., 285 F.R.D. 435 (N.D. Cal. 2012) (in reopened chapter 7 case, trustee and debtors appropriately entered into stipulation allowing debtors to prosecute unfair lending claims on behalf of bankruptcy estate, subject to debtors' exemption rights); *see also* Frese v. Empire Fin. Servs., 725 F. Supp. 2d 130 (D.D.C. 2010) (chapter 7 trustee to pursue unscheduled prepetition TILA rescission and damages claims unless decides to abandon claims to debtor).

must approve this representation. The process for approval of counsel to represent the estate is not particularly burdensome, and focuses on disclosure of the fee arrangement. The arrangement should provide that from the proceeds of the action the debtor receives amounts covered by exemptions and any sum left over after payments due creditors. The estate would be entitled to any non-exempt proceeds from the litigation.[29]

Reopening and amending, however, may not solve all problems for the debtor. Even when a debtor who initially omitted a legal claim from schedules reopens the closed bankruptcy case, adds the claim, and seeks to pursue the claim after abandonment or exemption, courts may still limit the debtor's rights over the claim.[30] For example, a court may consider evidence of the debtor's conduct in initially omitting the claim and deciding to add it belatedly. The court may look at factors such as the timing of the reopening in relation to the appearance of a standing objection, the length of time since the bankruptcy case was closed, and any evidence of deliberate misrepresentation.[31]

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[29] *In re* Beach, 447 B.R. 313 (Bankr. D. Idaho 2011) (debtor's interest in the exempt property gives her standing, along with trustee, to pursue TILA recoupment claim relating to debtor's exempt homestead interest); *see also* Paige v. Waukesha Health Sys., Inc., 2013 WL 3560944 (E.D. Wis. July 11, 2013) (debtor retained standing to pursue FDCPA action where claimed $1000 exemption in the claim valued at total of $4000 in the bankruptcy schedules); Miller v. Huntington Nat'l Bank, N.A., 2012 WL 4463877, at *3 (S.D. W. Va. Sept. 26, 2012) (transferring loan flipping case to bankruptcy court where case may be re-opened and extent of debtor's exemption in claim determined), *subsequent decision,* 2013 WL 593780, at *3-4 (N.D. W. Va. Feb. 15, 2013) (debtor claimed wildcard exemption of $20,000, chapter 7 trustee permitted to intervene for bankruptcy estate).

[30] Judicial estoppel standards developed in the Ninth and Seventh Circuit give significant consideration to a debtor's efforts to reopen and amend schedules. Metrou v. M.A. Mortenson Co., 781 F.3d 357, 360 (7th Cir. 2015) (the debtor-plaintiff who amends schedules to list omitted claim presumptively remains eligible to receive non-exempt proceeds remaining after creditors are paid from lawsuit; reversing trial court that set cap on amount recoverable from lawsuit based on amount needed to pay creditors); Ah Quin v. Cnty. of Kauai Dep't of Transp., 733 F.3d 267 (9th Cir. 2013). Other circuits do not share this view. Eastman v. Union Pac. Rail Co., 493 F. 3d 1151, 1160 (10th Cir. 2007) (reopening bankruptcy case, making creditors whole is "inconsequential"); Burnes v. Pemco Aeroplex, Inc., 291 F.3d 1282, 1288 (11th Cir. 2002) (allowing debtors to reopen and amend to avoid judicial estoppel would discourage truthful initial disclosures).

[31] Macauley v. Estate of Nicholas, 7 F. Supp. 3d 468 (E. D. Pa. 2014) (dismissal of mortgagor's fraud claim on bankruptcy standing grounds, court notes could allow

Consideration of equitable factors such as these is not a matter of standing, but involves the courts' broad authority to regulate litigation conduct. The doctrine of judicial estoppel, discussed below, is the remedy courts most often impose to address concerns for fairness and the integrity of the judiciary once the non-disclosure has been corrected.

4. The debtor's standing during and after chapter 13

Unlike in chapter 7, the chapter 13 debtor remains in possession of all property of the estate. Normally the debtor has the right to fully control any litigation.[32] Therefore most courts have held that a chapter 13 debtor has standing to pursue prepetition causes of action.[33] The debtor should also have the right to dictate the terms of any settlement of the foreclosure claim, though the bankruptcy court must normally approve the settlement.[34] The debtor should advise the chapter 13 trustee of any recovery, which depending upon the terms of the confirmed chapter 13 plan and allowed exemptions, may be distributed in full or in part to creditors.[35]

The chapter 13 bankruptcy estate, unlike the chapter 7 counterpart, may include property the debtor acquires after filing the initial petition for relief.[36] Under Ninth Circuit rulings, this remains true at least until the confirmation of a chapter 13 plan. The plan itself

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substitution but gives significant weight to fact that in several years after bankruptcy while aware of claim debtor did not try to open and amend).

[32] 11 U.S.C. §§ 1303, 1306(b); Foronda v. Wells Fargo Home Mortg., Inc., 2014 WL 6706815, at *4 (N.D. Cal. Nov. 26, 2014) (summarizing decisions); *see also* Wilson v. Dollar Gen. Corp., 717 F.3d 337 (4th Cir. 2013).

[33] Smith v. Rockett, 522 F.3d 1080 (10th Cir. 2008) (chapter 13 debtor can pursue prepetition debt collection case in own name on behalf of estate); Barker v. Asset Acceptance, L.L.C., 874 F. Supp. 2d 1062, 1065 (D. Kan. 2012) (debtor can pursue scheduled prepetition FDCPA action "in his capacity as a Chapter 13 bankruptcy debtor rather than in his individual capacity"); *In re* Simmerman, 463 B.R. 47 (Bankr. S.D. Ohio 2011) (chapter 13 debtors have standing to bring various consumer claims, including FDCPA claims, on behalf of bankruptcy estate; but FDCPA claims time-barred).

[34] *See* Fed. R. Bankr. P. 9019.

[35] *See* 11 U.S.C. §§ 1306(a), 1325(c), 1329.

[36] 11 U.S.C. § 1306(a).

may stipulate otherwise, but the Code provides that upon confirmation of the plan the estate's property vests in the debtor.[37] Thus, the debtor should also have standing to pursue legal claims that arise during the three-to-five years that a confirmed chapter 13 plan is in effect.[38]

Despite the chapter 13 debtor's right to litigate on behalf of the estate, the extent of the debtor's duty to amend schedules to include legal claims acquired while a chapter 13 case is pending is not clear. Given the debtor's continuing duty to disclose changes in his or her financial situation during the pendency of a chapter 13 case, the debtor may be required to amend the schedule of assets to include any legal claim that arises after the filing of the chapter 13 petition and during the pendency of the case. The safest course in these situations is to disclose the claim and amend the schedules. The debtor should also amend the schedule of exempt property to exempt the claim. The ability to amend schedules after the completion of a chapter 13 case is questionable.[39]

In chapter 13, as with chapter 7, resolving standing issues does not preclude courts' application of equitable remedies, such as judicial estoppel, when the omission of a claim from schedules was the product of a bad faith intent to conceal. As discussed below, judicial estoppel has been applied to bar claims not disclosed during the pendency of a chapter 13 case, regardless of whether the claims arose before the filing of the petition or during the pendency of the case.[40]

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[37] 11 U.S.C. § 1327(b); In *re* Jones, 420 B.R. 506 (B.A.P. 9th Cir. 2009), *aff'd,* 657 F.3d 921 (9th Cir. 2011).

[38] Note that the California Homeowners Bill of Rights ("HBOR") limits remedies under the statute for homeowners who have filed a chapter 7 or chapter 13 bankruptcy case and "the bankruptcy court has not entered an order closing or dismissing the bankruptcy case, or granting relief from a stay of foreclosure." Cal. Civ. Code § 2929.5(c)(2)(C). Given the relative length of cases under the two chapters, this provision obviously has much greater impact on chapter 13 than chapter 7 debtors.

[39] *In re* D'Antignac, 2013 WL 1084214 (Bankr. S.D. Ga. Feb. 19, 2013) (chapter 13 case cannot be reopened to administer an asset (a lawsuit) because § 1329(d) limits period of plan administration to five years, and seven years passed since commencement of plan).

[40] *See* note 43, *infra.*

III. Judicial Estoppel

1. What is judicial estoppel?

Judicial estoppel is a different doctrine that courts may apply in situations when a plaintiff is pursuing a legal claim that existed at the time of a prior bankruptcy case, but did not disclose the claim in the schedules filed with the bankruptcy court. Judicial estoppel and lack of standing are related in that both can be consequences of an omission from bankruptcy schedules. However, the concepts are distinct. For example, a plaintiff who overcomes a standing objection and is the proper party to pursue a claim may still be precluded from doing so by judicial estoppel. Courts sometimes apply both doctrines to dismiss a case.[41]

Judicial estoppel is an equitable doctrine intended to protect the integrity of the court by preventing a party from intentionally changing positions in litigation depending upon the "exigencies of the moment."[42] Under the doctrine, a party is precluded from asserting a position in a legal proceeding inconsistent with a position the same party adopted in a previous proceeding.

While there is no bright line test to determine when judicial estoppel may be invoked, the Supreme Court has focused on these general considerations: (1) whether the party's later position was clearly inconsistent with its earlier position; (2) whether the party succeeded in persuading the court to accept the earlier position, so that later judicial acceptance would suggest that the first or second court was deliberately misled; and (3) whether the party seeking to assert an inconsistent position would derive an unfair advantage or impose an unfair detriment on the opposing party.[43] Federal courts have imposed judicial estoppel in numerous instances when a party omitted a pre-bankruptcy legal claim from schedules, then attempted to assert the

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[41] *See, e.g.,* Johnson v. Deutsche Bank Nat'l Tr. Co., 2013 WL 3810715 (N.D. Tex. July 23, 2013) (challenge to foreclosure practices asserting various consumer claims, dismissed for bankruptcy-related lack of standing and judicial estoppel).
[42] New Hampshire v. Maine, 532 U.S. 742, 753 (2001).
[43] *Id.* at 750–51.

claim in a post-bankruptcy lawsuit.[44] In the courts' view, the party made inconsistent statements about the existence of the legal claim in two different proceedings. Courts have applied judicial estoppel in the context of both chapter 13 and chapter 7 cases.[45]

California state courts apply their own definition of judicial estoppel. According to the Court of Appeal in *Jackson v. County of Los Angeles,* judicial estoppel may apply when: "(1) the same party has taken two positions; (2) the positions were taken in judicial or quasi-judicial administrative proceedings; (3) the party was successful in asserting the first position (i.e., the tribunal adopted the position or accepted it as true); (4) the two positions are totally inconsistent; and (5) the first position was not taken as a result of ignorance, fraud, or mistake."[46] The California Supreme Court subsequently adopted this definition of judicial estoppel.[47] California courts have applied judicial estoppel to bar the later litigation of lender liability claims that were not listed in a debtor's bankruptcy schedules.[48] While the California state law definition includes an express exception for omissions due to mistake or ignorance, most federal courts acknowledge a similar exception. As discussed below,[49] the application of the "inadvertence or

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[44] Hamilton v. State Farm Fire & Cas. Co., 270 F.3d 778 (9th Cir. 2001) (debtor judicially estopped from bringing insurance claims when debtor listed insurance losses as liabilities, but did not list claim against insurer as asset on bankruptcy schedules). *See also* Moses v. Howard Univ. Hosp., 606 F.3d 789 (D.C. Cir. 2010); Eastman v. Union Pac. R. Co., 493 F.3d 1151 (10th Cir. 2007); Cannon-Stokes v. Potter, 453 F.3d 446 (7th Cir. 2006); Stallings v. Hussmann Corp., 447 F.3d 1041 (8th Cir. 2006); Jethroe v. Omnova Solutions, Inc., 412 F.3d 598 (5th Cir. 2005); Barger v. City of Cartersville, 348 F.3d 1289 (11th Cir. 2003); Krystal Cadillac Oldsmobile GMC Truck, Inc. v. Gen. Motors Corp., 337 F.3d 314 (3d Cir. 2003); Payless Wholesale Distribs., Inc. v. Alberto Culver, Inc., 989 F.2d 570 (1st Cir. 1993).

[45] *See, e.g.*, Kimberline v. Dollar Gen. Corp., 520 F. App'x 312 (6th Cir. 2013) (judicial estoppel applied where cause of action accrued during final weeks of five-year chapter 13 plan and debtor did not disclose claim before discharge); DeLeon v. Comcar Indus., Inc., 321 F.3d 1289 (11th Cir. 2003) (judicial estoppel applies in chapter 13 as well as in chapter 7 cases). *But see* Gilbreath v. Averitt Express, Inc., 2010 WL 4554090 (W.D. La. Nov. 3, 2010) (discussing rulings on status of legal claims that accrue after chapter 13 plan confirmation and before discharge; finding application of judicial estoppel inappropriate when claim arose post-confirmation).

[46] 60 Cal. App. 4th 171, 183 (1997).

[47] Aguilar v. Lerner, 32 Cal. 4th 974, 986-87, 88 P.3d 24 (Cal. 2004).

[48] Hamilton v. Greenwich Investors XXVI, L.L.C., 195 Cal. App. 4th 1602 (2011); Billmeyer v. Plaza Bank of Commerce, 42 Cal. App. 4th 1086 (1995).

[49] *See* note 63, below.

mistake" exception to judicial estoppel is unquestionably the most disputed aspect of the doctrine under federal law.

Judicial estoppel has its place in certain instances where a party made a calculated decision not to disclose a valuable claim to bankruptcy creditors. A paradigm example would be an individual planning to file a tort lawsuit worth hundreds of thousands of dollars. Assume that this person also had a hundred thousand dollars in unsecured debt. Filing a bankruptcy case first would allow the discharge of all the unsecured debt. If the debtor intentionally left the tort claim out of his schedules and later recovered several hundred thousand dollars in the lawsuit, this individual would arguably have misused the bankruptcy system. The unsecured creditors were deprived of recourse to a valuable asset of the debtor that would have paid off the unsecured debts in full. As discussed above, the circumstances surrounding consumer cases are usually very different. Bankruptcy debtors often do not understand that they have potential legal claims against a lender or servicer when they complete their schedules of assets in preparation for a bankruptcy filing. Because consumer claims can often be exempted or will be abandoned by the bankruptcy estate, debtors have little reason to engage in deliberate manipulation to conceal these claims. Nevertheless, federal courts in California and elsewhere in the Ninth Circuit have applied judicial estoppel to dismiss foreclosure-related claims,[50] as well as claims under consumer statutes such as the TILA[51] and the FDCPA.[52]

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[50] Snead v. Aurora Loan Servs., L.L.C., 2012 WL 3756887 (E.D. Cal. Aug. 28, 2012) (judicial estoppel bars borrower's claims for wrongful foreclosure where underlying facts were known to borrower before earlier bankruptcy filing and claims were not scheduled as asset); Young v. U.S. Bank Nat'l Ass'n, 2012 WL 3678631 (C.D. Cal. Aug. 24, 2012) (same).

[51] Demarest v. Ocwen Loan Servicing, L.L.C., 481 F. App'x 352, 353 (9th Cir. 2012) (affirming dismissal of borrowers' TILA rescission claim on basis of judicial estoppel, finding debtor "responsible for the consequences of her [bankruptcy] attorney's alleged negligence"); Gonzalez v. Nationstar Mortgage, 2011 WL 3798856 (E.D. Cal. Aug. 29, 2011) (dismissing TILA and other claims related to foreclosure where plaintiff had delayed foreclosure through a chapter 7 filing and had not scheduled the claims); Ash v. OneWest Bank, F.S.B., 2010 WL 2231972 (E.D. Cal. June 3, 2010) (dismissal of TILA claims on judicial estoppel and standing grounds); Flores v. GMAC Mortgage, 2010 WL 582115 (E.D. Cal. Feb. 11, 2010) (dismissing TILA

2. *The elements of judicial estoppel in the bankruptcy context*

The party's later position is clearly inconsistent with its earlier position. This first criterion is seldom an issue in bankruptcy judicial estoppel litigation. The basic inconsistency alleged is that in one proceeding the debtors signed a sworn declaration that they did not have a legal claim. In raising the claim in the later proceeding, the debtors are saying the opposite - that they do have the legal claim. In some instances plaintiffs successfully avoided judicial estoppel by arguing that the status of the law at the time of the bankruptcy filing did not support the legal claim, and the law later changed or was clarified to allow the claim.[53] Several decisions have turned on the question of whether the debtors actually disclosed the legal claims in their bankruptcy schedules. There is no hard and fast rule describing how a description of an inchoate legal claim must look.[54] If a less than complete description nevertheless gave reasonable notice to the trustee

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rescission claims because "[p]laintiffs had knowledge of the facts comprising their TILA claim during the pendency of their bankruptcy"); Neighbors v. Mortgage Elec. Registration Sys., Inc., 2009 WL 192445 (N.D. Cal. Jan. 27, 2009) (plaintiffs bringing TILA action had knowledge of all facts underlying the claims before they filed for bankruptcy relief and did not disclose claims).

[52] Black v. Midland Credit Mgmt., Inc., 2013 WL 5140181 (W.D. Wash. Sept. 12, 2013) (receipt of debt collection letter before she filed for bankruptcy relief gave debtor enough information to know she should have listed FDCPA claim in her bankruptcy schedules); Otter v. Northland Croup, Inc., 2013 WL 2243874 (W.D. Wash. May 21, 2013) (debtor aware of collection letters and did not amend schedules during pendency of bankruptcy case and before discharge); Kee v. Evergreen Prof'l Recoveries, Inc., 2009 WL 2578982 (W.D. Wash. Aug. 19, 2009) (consumer judicially estopped from proceeding with debt collection claim not listed in bankruptcy); Allers-Petrus v. Columbia Recovery Group, L.L.C., 2009 WL 799676 (W.D. Wash. Mar. 24, 2009) (FDCPA claim dismissed where debtor did not schedule known claim and did not seek to amend until after defendant filed summary judgment motion).

[53] Meyer v. U.S. Bank Nat'l Ass'n, __ B.R __, 2015 WL 1619048, at *6 (W. D. Wash. Apr. 10, 2015) (judicial estoppel not applied where bankruptcy court did not rely on absence of legal claim in schedules; unsettled issues of state foreclosure law were clarified after bankruptcy and debtors not aware had legal claim at time of bankruptcy); Balik v. Blitt & Gaines, P.C., 2015 WL 764013 (N.D. Ill. Feb. 21, 2015) (judicial estoppel not applicable to FDCPA claim where nature of distant forum violation substantially clarified by post-bankruptcy U.S. court of appeals decision, but case dismissed on other grounds). *But see In re* Goldstein, 526 B.R. 13 (B.AP 9th Cir. 2015) (rejecting debtor's argument that at time of bankruptcy filing in 2010 the law did not yet support fraud, breach of contract, and promissory estoppel claims involving failure to convert a HAMP trial plan).

[54] *In re* Mohring, 142 B.R. 389, 395 (Bankr. E.D. Cal. 1992).

that the legal claim existed, this should suffice to avoid judicial estoppel.[55]

The party persuaded the earlier court to accept the earlier position. In judicial estoppel rulings there is typically little analysis of whether the omission made any practical difference in the debtor's obtaining a bankruptcy discharge. For example, omission of a claim that would have been exempt had it been scheduled does not have any effect on the debtor's obtaining a discharge. However, many courts would find that this factor, in and of itself, makes little difference in the application of judicial estoppel.[56]

Granting a discharge is the "position" adopted by a bankruptcy court that most often triggers judicial estoppel. Short of entering the discharge order, it is less clear what other "positions" adopted by the bankruptcy court are sufficient to bring judicial estoppel into play. One issue is whether the imposition of the automatic stay is enough. Defendants have argued that courts should impose judicial estoppel in situations where the debtor benefitted from the automatic stay in a past bankruptcy even though the debtor did not obtain a discharge. The Ninth Circuit in *Hamilton v. State Farm Fire & Cas. Co.* affirmed the imposition of judicial estoppel in a case in which the bankruptcy court had entered a chapter 7 discharge, but later revoked the discharge after a finding of debtor bad faith.[57] The decision suggests that in certain cases merely benefitting from the automatic stay could suffice as the "position" adopted by the bankruptcy court that justifies

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[55] Foronda v. Wells Fargo Home Mortg., Inc., 2014 WL 6706815 (N.D. Cal. Nov. 26, 2014) (judicial estoppel not applied where debtor failed to list claim against mortgagee in schedule B, but listed lawsuit in Statement of Financial Affairs); Wahlman v. Datasphere Tech., Inc., 2014 WL 794269, at *5 (W.D. Wash. Feb. 27, 2014) (designating what later became employment discrimination lawsuit as "EEOC Claims" in bankruptcy schedules was sufficiently specific to preclude judicial estoppel). *But see* Bernardi v. Deutsche Bank Nat'l Tr. Co. Am., 2013 WL 163285 (N.D. Cal. Jan. 15, 2013) (detail in scheduling claim insufficient to preclude judicial estoppel; debtor identified active mortgage litigation generally in schedule of assets, but in Statement of Financial Affairs referenced only one specific case against one of the several entities targeted in lawsuits).

[56] *But see* Schneider v. Unum Life Ins. Co. of Am., 2008 WL 109065, at *6 (D. Or. Jan. 8, 2008) (declining to impose judicial estoppel, finding, *inter alia*: "[b]ecause the lawsuit proceeds would be exempt, I find no evidence of prejudice to creditors.").

[57] 270 F.3d 778, 784-85 (9th Cir. 2001).

judicial estoppel. More recent decisions from California courts have reached different conclusions on this question. This has been true both in the federal courts[58] and in state courts.[59] Debtors who engage in repeat bankruptcy filings to stave off foreclosures with no effort to obtain a discharge are most likely to face judicial estoppel based solely on the benefit of the stay.[60] Aside from these repeat-filer cases, it is difficult to see how a temporary, automatic imposition of the bankruptcy stay where no discharge followed should amount to the bankruptcy court's "adoption" of a position based on anything in the debtor's schedules.[61]

Chapter 13 cases often end with a dismissal without entry of a discharge order. Specific questions arise as to what actions by the

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[58] Zyla v. Am. Red Cross Blood Services, 2014 WL 3868235 (N.D. Cal. Aug. 6, 2014) (where plan amended to add omitted claim and mistake averred, benefit debtor received from automatic stay not sufficient to impose judicial estoppel); Boatright v. Aurora Loan Servs., 2012 WL 2792415 (N.D. Cal. July 9, 2012) (mere imposition of automatic stay in prior chapter 13 case without confirmation of plan did not create requisite benefit to debtor to justify imposition of judicial estoppel); Perez v. Wells Fargo Bank, N.A., 2011 WL 3809808 (N.D. Cal. Aug. 29, 2011) (no judicial estoppel of TILA and other consumer claims where chapter 13 plan not confirmed before dismissal of bankruptcy case; mere activation of automatic stay did not create pertinent benefit for debtor). *See also* Nissim v. Wells Fargo Bank, N.A, 2014 WL 4421384 (N. D. Cal. Sept. 5, 2014) (several past bankruptcies involved; refusing judicial estoppel in one chapter 13 case where no discharge or plan confirmation occurred).

[59] Gottlieb v. Kest, 141 Cal. App. 4th 110 (2006) (implementation of automatic stay not sufficient to trigger adoption of legal position prong of judicial estoppel test); Campbell v. Bank of Am., 2013 WL 3833669 (Cal. App. July 24, 2013) (implementation of stay in dismissed bankruptcy cases not sufficient to meet requirement for court adoption of position, borrower may pursue loan servicing claims); Hamilton v. Greenwich Investors XXVI, L.L.C., 195 Cal. App. 4th 1602 (2011) (imposing judicial estoppel, noting benefit of automatic stay and confirmation of chapter 13 plan).

[60] Sharp v. Nationstar Mortg., LLC, 2015 WL 106844 (N.D. Cal. Jan. 7, 2015) (judicial estoppel applied where debtor filed four consecutive bankruptcy cases that were dismissed without discharge, delaying foreclosures); Swendsen v. Ocwen Loan Servicing, LLC, 2014 WL 1155794 (E.D. Cal. Mar. 21, 2014) (automatic stay in two prior bankruptcies); HPG Corp. v. Aurora Loan Servs., L.L.C., 436 B.R. 569 (E.D. Cal. 2010) (judicial estoppel applied against debtors who did not obtain discharges in prior bankruptcy cases but who obtained benefits of automatic stay in multiple cases).

[61] Perez v. Wells Fargo Bank, N.A., 2011 WL 3809808, at *12 (N.D. Cal. Aug. 29, 2011) (distinguishing *Hamilton,* rejects argument that judicial estoppel should be predicated solely upon imposition of automatic stay, noting "[a] stay would have been entered in the bankruptcy action regardless of whether [the debtor] listed any claims in her bankruptcy filings.").

bankruptcy court, short of granting a discharge, trigger judicial estoppel for chapter 13. Most courts focus on the plan confirmation order.[62] Debtors are more likely to face judicial estoppel if the court confirmed a plan while a legal claim remained unscheduled than if the chapter 13 case was dismissed before confirmation. As with chapter 7, the benefit of the automatic stay alone may qualify as sufficient court adoption of the content of the debtor's schedules.[63] However, advocates should argue that the court must find some more pervasive misuse of the bankruptcy system before a temporary benefit from the automatic stay can trigger judicial estoppel.

The party would derive an unfair advantage or impose an unfair detriment on the opposing party if it asserts inconsistent positions. This third estoppel criterion refers to two alternative elements: an unfair advantage to the plaintiff or an unfair detriment to the defendant. An omission from bankruptcy schedules may not have any impact on the defendant in the post-bankruptcy litigation. The focus is more often on the plaintiff – whether the plaintiff obtains an "unfair" benefit because of the past omission.

Nearly all courts agree that there would be no unfair advantage for the debtor-plaintiff if the earlier omission resulted from mistake or inadvertence.[64] Since the defendant can usually establish the major

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[62] Sannah v. Wells Fargo Bank, N.A., 2012 WL 10423186, at *4 (C.D. Cal. Mar. 19, 2012) (no judicial estoppel where chapter 13 plan never filed before dismissal); Chancellor v. OneWest Bank, 2012 WL 1868750 (N.D. Cal. May 22, 2012) (borrower's wrongful foreclosure and RESPA claims not barred by judicial estoppel where chapter 13 plans not confirmed in prior bankruptcies); Hamilton v. Greenwich Investors XXVI, L.L.C., 195 Cal. App. 4th 1602 (2011) (judicial estoppel barred consumer's lender liability claims where claims not scheduled in debtor's pending chapter 13 case; plan had been confirmed, distinguishing cases in which plans not confirmed); *see also In re* Oparaji, 698 F.3d 231, 238 (5th Cir. 2012) (refusing to apply judicial estoppel to creditor because confirmation of plan did not represent judicial acceptance of a position in a chapter 13 case dismissed without discharge).

[63] Becker v. Wells Fargo Nat'l Ass'n, 2012 WL 5187792 (E.D. Cal. Oct. 18, 2012) (judicial estoppel applied where debtor failed to disclose legal claims related to an improper foreclosure sale that occurred after the bankruptcy petition was filed but before chapter 13 plan confirmed).

[64] New Hampshire v. Maine, 532 U.S. 742, 753 (2001); Javery v. Lucent Tech., Inc. Long Term Disability Plan for Mgmt. or LBA Employees, 741 F.3d 686, 698 (6th Cir 2014) (failure to disclose a claim in a bankruptcy proceeding may be excused where it occurred by mistake or inadvertence); Ah Quin v. Cnty. of Kauai Dep't of Transp.,

elements of judicial estoppel from court documents and timing, the "mistake or inadvertence" standard becomes the focal point of most litigation over bankruptcy estoppel. It would be highly unusual to come across a case in which a homeowner intentionally concealed a consumer claim from bankruptcy schedules in order to gain an unfair advantage in later litigation. Homeowners almost always have valid grounds for asserting mistake or inadvertence as the basis for the omission. Unfortunately courts around the country have formulated presumptions and other procedural barriers that have made it difficult for plaintiffs to present their evidence of mistake or inadvertence. This is an area where recent developments in the Ninth Circuit law may place plaintiffs in federal court in California in a somewhat better position than litigants facing judicial estoppel in other circuits.

3. The Ninth Circuit's standard for consideration of "mistake or inadvertence."

Under a test commonly applied in federal courts, the omission of a cause of action from bankruptcy schedules is deemed deceitful (i.e., "unfair") if the debtor had knowledge of the factual basis for the undisclosed claim and had a motive to conceal it.[65] The requisite "knowledge" is deemed to be the awareness of the general facts associated with the potential claim.[66] Thus, the fact that a homeowner

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733 F.3d 267, 276-77 (9th Cir. 2013) (if schedules amended, court must consider evidence of mistake and inadvertence in original omission); Eubanks v. CBSK Fin. Group, Inc., 385 F.3d 894 (6th Cir. 2004) courts must consider inadvertence, mistake in all judicial estoppel cases); John S. Clark Co. v. Faggert & Frieden, Co., 65 F.3d 26, 29 (4th Cir. 1995) (inappropriate to apply judicial estoppel in case of mistake or inadvertence).

[65] Moses v. Howard Univ. Hosp., 606 F.3d 789, 800 (D.C. Cir. 2010); Eastman v. Union Pac. R.R. Co., 493 F.3d 1151, 1157 (10th Cir. 2007); Krystal Cadillac Oldsmobile GMC Truck, Inc. v. Gen. Motors Corp., 337 F.3d 314, 321 (3d Cir. 2003); Barnes v Pemco Aeroplex, Inc., 291 F.3d 1282 (11th Cir. 2002); *In re* Coastal Plains, 179 F.3d 197 (5th Cir. 1999).

[66] Krystal Cadillac Oldsmobile GMC Truck, Inc. v. Gen. Motors Corp., 337 F.3d 314, 321 (3d Cir. 2003) (rebuttable inference of bad faith arises when averments in pleadings demonstrate knowledge of a claim and a motive to conceal that claim in the face of an affirmative duty to disclose); *In re* Coastal Plains, Inc., 179 F.3d 197 (5th Cir. 1999) (debtor's knowledge of enough information to suggest that it may have a

possessed a loan document, received a letter from a lender's attorney, or was verbally told something by a servicer could be enough to establish that the homeowner had "knowledge" of a cause of action before filing a bankruptcy petition.[67] It does not matter that only years later in a conversation with an attorney the homeowner learns that there is a TILA violation buried in the loan documents or that the communications from the lender's attorney violated the FDCPA.

Many courts imply the intent and motivation to deceive from the combination of a broad view of "knowledge" and from the timing of the bankruptcy filing. The knowledge and timing create a presumption that the debtor left out the claim in order to obtain the benefit of a bankruptcy discharge while retaining a valuable asset.[68] Under certain rulings plaintiffs can face a nearly insurmountable burden in rebutting this presumption. The plaintiff's burden is not to rebut a specific allegation of bad faith, but instead to prove the absence of all bad faith.[69] The harshest aspect of this standard is that it ignores efforts to amend schedules and correct any concrete harm that the omission may have caused to creditors.[70]

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possible cause of action coupled with failure to schedule claim sufficient to support application of judicial estoppel doctrine).

[67] *See e.g.* McFarland v. JP Morgan Chase Bank, 2014 WL 4119399 (C.D. Cal. Aug. 21, 2014) (borrower's awareness of loan terms before bankruptcy, not legal claims triggered by those terms, sufficient for judicial estoppel).

[68] Eastman v. Union Pac. R.R. Co., 493 F.3d 1151, 1157 (10th Cir. 2007); Barger v. City of Cartersville, 348 F.3d 1289 (11th Cir. 2003); *In re* Coastal Plains, 179 F.3d 197 (5th Cir. 1999).

[69] *See e.g.,* Dockery v. Countrywide Home Loans, Inc., 2010 WL 2667376 (W.D. Ky. July 1, 2010) (burden of establishing absence of bad faith on debtor when defendant in subsequent action has shown debtor possessed knowledge of the factual basis of the claims in prior bankruptcy and had motive to conceal them from bankruptcy court).

[70] Moses v. Howard Univ. Hosp., 606 F.3d 789, 800 (D.C. Cir. 2010) (finding debtor's argument that he reopened bankruptcy case, amended schedules and invited trustee to intervene to be "wholly unpersuasive"); Eastman v. Union Pac. Rail Co., 493 F.3d 1151, 1160 (10th Cir. 2007) (reopening bankruptcy case, making creditors whole is "inconsequential"); Burnes v. Pemco Aeroplex, Inc., 291 F.3d 1282, 1288 (11th Cir. 2002) (allowing debtors to reopen and amend to avoid judicial estoppel would discourage truthful initial disclosures); Robinson v. Dist. of Columbia, 10 F. Supp. 3d 181 (D.D.C. 2014) (because reopening bankruptcy case to schedule omitted debt will have no impact on court's decision to apply judicial estoppel, court may dismiss employment action without allowing reopening); Barker v. Asset Acceptance, L.L.C.,

The Ninth Circuit's 2013 ruling in *Ah Quin v. County of Jauai Department of Transportation* set out a roadmap leading to a fairer consideration of evidence of mistake or inadvertence in judicial estoppel cases.[71] *Ah Quin* involved the plaintiff in an employment discrimination case. The plaintiff's lawsuit was already pending when she filed her chapter 7 petition. She did not disclose the lawsuit in her schedules and obtained a discharge. After the defendant in the employment case raised judicial estoppel, the plaintiff reopened her bankruptcy case and amended her schedules. The bankruptcy trustee abandoned any interest in the lawsuit. The trial court then granted summary judgment for the defendant employer. The trial court considered the reopening and amendment irrelevant. Instead the court found an intent to deceive from the straightforward application of the presumption – the plaintiff knew about her legal claim and, like all bankruptcy debtors, she had a motive to conceal the claim from creditors. According to the trial court, the plaintiff's assertion that she initially omitted the claim out of mistake and inadvertence was insufficient to defeat the formalistic presumption of intent to deceive.

The court of appeals in *Ah Quin* reversed. In doing so the court gave substantial weight to the plaintiff's reopening and amendment. The court began by agreeing that *absent the reopening and amendment*, application of a presumption of intent would be appropriate.[72] However, this corrective action effectively removed the "unfair advantage" element necessary for application of judicial estoppel.[73] Instead, the relevant inquiry became whether the defective filing "was, in fact, inadvertent or mistaken, as those terms are commonly understood."[74] This meant consideration of evidence of

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874 F. Supp. 2d 1062 (D. Kan. 2012) (judicial estoppel barred chapter 13 debtor from pursuing prepetition unfair debt collection action despite amending his schedules to add claim in response to creditor's motion raising judicial estoppel).

[71] Ah Quin v. Cnty. of Kauai Dep't of Transp., 733 F.3d 267 (9th Cir. 2013).

[72] *Id.* at 272-73.

[73] *Id.* at 274.

[74] *Id.* at 276.

subjective intent, not reliance on a presumption. According to the appellate court,

> Courts must determine whether the omission occurred by accident or was made without intent to conceal. The relevant inquiry is not limited to the plaintiff's knowledge of the pending claim and the universal motive to conceal a potential asset – though those are certainly factors. The relevant inquiry is, more broadly, the plaintiff's subjective intent when filling out and signing the bankruptcy schedules."[75]

Under the *Ah Quin* standard the party defending against judicial estoppel must still present some evidence that the omission was the result of mistake or inadvertence.[76] For unsophisticated homeowners, however, it should not be difficult to present straightforward evidence of an honest mistake. Significantly, the plaintiff does not bear a generalized burden to prove a negative – an absence of bad faith. Courts in the Seventh Circuit have followed the Ninth Circuit's analysis and also provide a helpful guide to judicial estoppel issues.[77]

The *Ah Quin* ruling is important because it squarely addresses one of the major problems plaintiffs have faced in dealing with judicial

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[75] *Id.* at 276-77.

[76] Zyla v. Am. Red Cross Blood Services, 2014 WL 3868235 (N.D. Cal. Aug. 6, 2014) (applying *Ah Quin*; after amending chapter 13 plan, debtor may show had no subjective intent to deceive by establishing she had informed her bankruptcy attorney of claim and relied on attorney to complete bankruptcy papers appropriately). *But see* Dzakula v. McHugh, 746 F.3d 399 (9th Cir. 2014) (merely amending schedules without offering some evidence of mistake or inadvertence in initial omission does not rebut presumption of deceit for summary judgment purposes); *see also* Giri v. HSBC Bank USA, __ F. Supp. 3d __, 2015 WL 247811 (D. Nev. Jan. 20, 2015) (addressing complaint alleging wrongful foreclosure contrary to SCRA and applying *Ah Quin,* court finds plaintiff subject to presumption of deceit (aware of facts when filed; knowledge equals motive) but if amends schedules court will consider "inadvertence or mistake" and subjective intent); Gonzalez v. Cnty. of Yolo, 2014 WL 5115059 (E.D. Cal. Oct. 10, 2014) (applying *Ah Quin* and allowing depositions of debtor and bankruptcy attorney on subjective intent).

[77] Spaine v. Cmty. Contacts, Inc., 756 F.3d 542 (7th Cir. 2014) (no presumption of intent to deceive arises where debtor amended schedules and provides some evidence had no subjective intent to mislead); Thompson v. Vill. of Monee, 2014 WL 4175915 (N. D. Ill. Aug. 22, 2014) (defendant must meet burden of showing intent to deceive if debtor reopened bankruptcy and amended schedules).

estoppel. Defendants tend to raise judicial estoppel at the early stages of a legal proceeding, typically by way of a motion for summary judgment or a motion to dismiss. The presumption of intent to deceive presents a significant barrier to the party responding to one of these motions. The respondent essentially loses the favorable inferences that otherwise apply in defending such a motion. When a presumption is applied, ruling on judicial estoppel in early dispositive motions is particularly inappropriate.[78] The trial court in *Ah Quin* applied the typical presumption to enter summary judgment for the defendant and did not consider the plaintiff's evidence of mistake and inadvertence. The court of appeals, on the other hand, held that, given the corrective action that dispelled the presumption, the plaintiff was entitled to have the evidence of mistake an inadvertence in her affidavit in response to summary judgment considered in the light most favorable to her.[79]

Other defenses: Was it really a pre-petition claim? Judicial estoppel assumes that the undisclosed legal claim at issue was property of the bankruptcy estate and would have been available to pay creditors if it had been disclosed. As was true for the analysis of standing, defendants may err in assuming that the claim belonged to the bankruptcy estate. A claim's inclusion in the bankruptcy estate depends on when it arose. Judicial estoppel cannot apply if the pertinent events occurred *after* the consumer filed a chapter 7

[78] Sullivan v. H & M Int'l Transp., Inc., 2015 WL 720988 (N.D. Ill Feb. 13, 2015) (denying judicial estoppel on motion for judgment on pleadings); Thomas v. Indiana Oxygen Co., 32 F. Supp. 3d 983 (S.D. Ind. 2014) (judicial estoppel not properly raised by Rule 12(b)(1) motion); David v. Wal-Mart Stores, Inc., 2014 WL 5510986 (N.D. Ill. Oct. 24, 2014) (refusing to apply judicial estoppel on Rule 12(b)(6) motion); Jackson v. WellSpan Health, 2014 WL 414251, at * 6-7 (M.D. Pa. Feb. 4, 2014) (courts should be reluctant to approve judicial estoppel at pleading stage; the party to be judicially estopped must be given a meaningful opportunity to explain its position); *see also In re* Simmerman, 463 B.R. 47, 56 (Bankr. S.D. Ohio 2011) (denying motion to dismiss debt collection claims based on judicial estoppel, "the court cannot determine, based solely on allegations in the complaint, whether any failure to disclose in the prior case was inadvertent or without motive"; but finds FDCPA claims time-barred); Schreiber v. Ocwen Loan Servicing, L.L.C., 2011 WL 6055425 (M.D. Fla. Oct. 17, 2011) (because judicial estoppel focuses on party's intent in earlier omission of consumer claims from bankruptcy schedules, court will not decide judicial estoppel issue on motion to dismiss), *adopted by* 2011 WL 6055417 (M.D. Fla. Dec. 6, 2011).
[79] Ah Quin v. Cnty. of Kauai Dep't of Transp., 733 F.3d 267, 278 (9th Cir. 2013).

petition.[80] Legal claims that the debtor acquires after filing the chapter 7 petition do not belong to the bankruptcy estate and there is no duty to disclose them. For example, in *Moreno v. Wells Fargo Home Mortgage*,[81] the U.S. district court for the Eastern District of California denied judicial estoppel where the debtors had filed bankruptcy in reliance on a servicer's promise to consider them for a loan modification if they got rid of their unsecured debts. After the debtors filed their bankruptcy petition, the servicer refused to consider them for a modification - because they had filed for bankruptcy. Although the servicer's promise occurred before the bankruptcy filing, the debtors' legal claim arose post-petition. There was no obligation to list this claim in their chapter 7 schedules.

The issues surrounding composition of the bankruptcy estate are different in Chapter 13. The duty to disclose continues until a chapter 13 plan is confirmed. The Ninth Circuit generally follows the view that the confirmation of the chapter 13 plan vests property of the bankruptcy estate in the debtor, as § 1327(b) of the Bankruptcy Code provides.[82] However, plan terms can vary this rule. In addition, many

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[80] Garcia v. Receivables Performance Mgmt., LLC, 2014 WL 5543885 (N.D. Ill. Nov. 3, 2014) (FDCPA claims arose after conversion of bankruptcy case to chapter 7 and therefore debtor had no duty to disclose and schedule claims; fact that underlying debt arose pre-bankruptcy not determinative); *In re* Rivera, 2014 WL 287517 (Bankr. E.D. Va. Jan. 27, 2014) (rejecting creditor's standing and judicial estoppel claims; while the creditor's promise to modify loan occurred pre-petition, the foreclosure sale that was the subject of complaint occurred after chapter 7 filing; debt collection claims dismissed on other grounds); *see also In re* Rivera, 2014 WL 287517 (Bankr. E.D. Va. Jan. 27, 2014) (because debtor's major claims related to a foreclosure that occurred post-petition and not to origination issues, judicial estoppel not applicable); Famatiga v. Mortg. Elec. Registration Sys., Inc., 2011 WL 3320480 (E.D. Mich. Aug. 2, 2011) (no judicial estoppel where major part of borrower's claim related to a wrongful foreclosure that occurred after the bankruptcy filing); Doran v. Wells Fargo Bank, 2011 WL 2160643 (D. Haw. May 31, 2011) (judicial estoppel applied to one claim related to series of foreclosure actions lender took against borrower, but not to other claims related to misconduct that occurred postpetition). *But cf.* Clementson v. Countrywide Fin. Corp., 464 F. App'x 706 (10th Cir. 2012) (unreported) (borrower's efforts to modify mortgage loan were rooted in lender's prebankruptcy pattern of conduct so that failure to schedule legal claims against lender triggered judicial estoppel).

[81] 2014 WL 5934722 (E.D. Cal. Nov. 12, 2014).

[82] 11 U.S.C. § 1327(b); In *re* Jones, 420 B.R. 506 (B.A.P. 9th Cir. 2009), *aff'd,* 657 F.3d 921 (9th Cir. 2011). *Compare In re* Flugence, 738 F. 3d 126 (5th Cir. 2013) (imposing

courts recognize a general duty to disclose legal claims the debtor acquires during the entire pendency of a chapter 13 case, before and after confirmation.[83] Therefore, the safest course is always to disclose legal claims acquired post-confirmation while a chapter 13 case is pending.

The implications of reopening a bankruptcy case. When faced with a judicial estoppel challenge, the plaintiff can take corrective action. The plaintiff can seek to reopen a closed bankruptcy case, file an amended schedule listing the legal claim, and have the claim exempted, administered, or abandoned. The Ninth Circuit's decision in *Ah Quin* makes taking these steps essential to an effort to defeat judicial estoppel. Even before the *Ah Quin* decision courts in the Ninth Circuit favored reopening and amendment over outright dismissal of the debtor's lawsuit.[84]

In the past, courts tended to look unfavorably upon debtors who sought to reopen and amend *after* the defendant raised judicial estoppel in the post-bankruptcy lawsuit. In particular, courts looked askance at cases where the lawsuit in question had already been filed when the debtor sought bankruptcy relief or when the debtor filed the undisclosed lawsuit during bankruptcy.[85] Plaintiffs are more likely to

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judicial estoppel to bar debtor from litigating undisclosed claim that arose during chapter 13 case after confirmation of plan).

[83] *See* II. 4, *supra*.

[84] *In re* Lopez, 283 B.R. 22 (B.A.P. 9th Cir. 2002) (debtor should have been permitted to reopen and amend to schedule cause of action because, even if claim had been intentionally concealed, asset could be administered to benefit creditors); Kurchack v. Life Ins. Co. of N. Am., 725 F. Supp. 2d 855 (D. Ariz. 2010) (allowing debtor to amend schedules to claim exemption for lawsuit proceeds after discharge and after motion to dismiss filed). *See generally* Just Film, Inc. v. Merchant Servs., Inc., 873 F. Supp. 2d 1171, 1178–79 (N.D. Cal. 2012) (rejecting judicial estoppel and standing challenges where proposed class representative had informed his attorney and trustee of claim during his bankruptcy case and amended schedules after reopening bankruptcy case); Cannata v. Wyndham Worldwide Corp., 798 F. Supp. 2d 1165 (D. Nev. 2011) (discussing various circuits' approaches to allowing amendment when omission from schedules was inadvertent).

[85] *See e.g.* Daniel v. Wells Fargo Bank, N.A., 2012 WL 2118539 (E.D. Cal. June 4, 2012) (judicial estoppel applied against plaintiffs who pursued lawsuit raising TILA and other pre-bankruptcy consumer claims while bankruptcy pending and did not amend schedules during bankruptcy); Webb v. Bayview Loan Servicing, L.L.C., 2013 WL 2039275 (D. Or. May 9, 2013) (rejecting inadvertent mistake explanation where

avoid judicial estoppel if they take corrective action *before* filing their lawsuit. However, it should be noted that the debtor in *Ah Quin* reopened her closed bankruptcy case and amended only after the defendant raised judicial estoppel. At least for the summary judgment stage, the Court of Appeals did not give any conclusive weight to this timing issue. Instead, the court defined the relevant inquiry to be "the plaintiff's subjective intent when filling out and signing the bankruptcy schedules."[86] While the debtor's knowledge of an existing lawsuit would certainly bear on this intent, the timing of reopening should not.

Reopening a closed bankruptcy case can entail certain risks. The debtor needs to evaluate exemption options before taking this step. If the legal claims appear to have significant value, the trustee will be inclined to take them over. In certain situations the trustee's taking over the case may not be the worst outcome. This may be preferable to an outright dismissal of the lawsuit. Judicial estoppel does not apply to a bankruptcy trustee.[87] The trustee may hire the consumer's counsel to prosecute the claim on behalf of the bankruptcy estate. The debtor should remain eligible to receive any proceeds from the litigation

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borrowers had filed action challenging foreclosure sale before they filed bankruptcy petition). *See generally* White v. Vacation Ownership, Inc., 617 F.3d 472 (6th Cir. 2010) (bad faith where no attempt to amend chapter 13 debtor's schedules until after defendant in ongoing employment discrimination case filed motion to dismiss raising estoppel); Moses v. Howard Univ. Hosp., 606 F.3d 789 (D.C. Cir. 2010) (estoppel applied where employment discrimination case pending before bankruptcy filing and debtor did not reopen case and amend until after motion to dismiss filed); Barger v. City of Cartersville, 348 F.3d 1289 (11th Cir. 2003) (monetary damages claim from employment discrimination action dismissed as lawsuit had been pending before bankruptcy petition filed and debtor did not seek to reopen to amend until served with motion to dismiss).

[86] Ah Quin v. Cnty. of Kauai Dep't of Transp., 733 F.3d 267, 276-77 (9th Cir. 2013).

[87] Stephenson v. Malloy, 700 F.3d 265 (6th Cir. 2012) (chapter 7 trustee can pursue prepetition legal claim despite debtor's inadvertent omission of claim from schedules); Reed v. City of Arlington, 650 F.3d 571 (5th Cir. 2011) (en banc) (application of judicial estoppel to a bankruptcy trustee is inconsistent with purpose of the bankruptcy law to preserve assets for distribution to estate's innocent creditors); Copelan v. Techtronics Indus. Co., __ F. Supp. 3d __, 2015 WL 1413107 (S. D. Cal. Mar. 27, 2015) (judicial estoppel inapplicable to trustee who has been substituted as party plaintiff); Lupian v. Central Valley Builders, 2014 WL 465445 (S.D. Cal. Feb. 5, 2014) (showing of mistake/inadvertence not necessary for trustee to pursue claim); Coble v. DeRosia, 823 F. Supp. 2d 1048 (E.D. Cal. 2011) (judicial estoppel not applicable to trustee).

subject to exemptions and any amounts left over after the appropriate distribution to creditors. If a court finds that the debtor's initial non-disclosure of the legal claim was intentional, the court could potentially limit the debtor's access to proceeds from a lawsuit. However, such a sanction should be issued only after a finding of intentional misconduct. The bankruptcy court, not the trial court hearing the post-bankruptcy lawsuit, should make this determination.[88]

In response to an assertion of judicial estoppel debtor's counsel should emphasize that strict application of the doctrine provides an undeserved windfall to a defendant and does nothing to promote the interests of bankruptcy creditors. Many courts have criticized strict application of judicial estoppel on these grounds.[89] The bankruptcy

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[88] *See. e. g.*, Metrou v. M.A. Mortenson Co., 781 F.3d 357, 360 (7th Cir. 2015) (reversing trial court that had placed cap on plaintiff's recovery based on amount needed to pay off bankruptcy creditors: "a debtor who errs in good faith, and tries to set things right by surrendering the asset to the Trustee, remains entitled to any surplus after creditors have been paid, just as would have occurred had the claim been disclosed on the bankruptcy schedules."). *But compare* Cannata v. Wyndham Worldwide Corp., 798 F. Supp. 2d 1165 (D. Nev. 2011) (allowing bankruptcy trustee to proceed with debtor's employment discrimination action, but limits recovery to amounts needed to pay creditors and disallows any recovery for plaintiff) *and* Kurchack v. Life Ins. Co. of N. Am., 725 F. Supp. 2d 855 (D. Ariz. 2010) (debtor gains no benefit from omitting exempt claim from schedules; after discharge debtor may amend schedules to claim exemption for lawsuit proceeds).

[89] Ah Quin v. Cnty. of Kauai Dep't of Transp., 733 F.3d 267, 275-76 (9th Cir. 2013) (noting harmful effect of judicial estoppel on administration of bankruptcy cases); *In re* An-Tze Cheng, 308 B.R. 448, 459 (B.A.P. 9th Cir. 2004), *aff'd,* 160 F. App'x 644 (9th Cir. 2005) ("Commentators are beginning to perceive problems inherent in the nature of bankruptcy as a collective proceeding that may make the remedy [of judicial estoppel] worse than the disease."); *see also* Stallings v. Hussmann Corp., 447 F.3d 1041, 1049 (8th Cir. 2006) (courts should apply the doctrine only as an extraordinary remedy when a party's inconsistent behavior will result in a miscarriage of justice); Biesek v. Soo Line R. Co., 440 F.3d 410 (7th Cir. 2006) (noting harm to creditors from application of judicial estoppel; permitting trustee to go ahead with claim is the more appropriate option); Parker v. Wendy's Int'l, Inc., 365 F.3d 1268, 1272 (11th Cir. 2004) (approving trustee's standing to reopen bankruptcy case to allow trustee to administer claim is a more appropriate remedy than dismissal of action through judicial estoppel); Pavelka v. Allstate Prop. & Cas. Ins. Co., __ F. Supp. 3d __, 2015 WL 1221393, at *3 (E.D. Mich. Mar. 18, 2015) (judicial estoppel is a "powerful defense" and "should be applied with caution"); United Fire & Cas. Co. v. Thompson, 949 F. Supp. 2d 922 (E.D. Mo. 2013) (rejecting judicial estoppel, noting harm to creditors and windfall to defendants if doctrine applied); Williams v. Republic Recovery Servs., 2010 WL 2195519, at *2 (N.D. Ill. May 27, 2010) (a strictly enforced judicial estoppel rule would "needlessly punish those debtors who fail to disclose claims due to mistake, misunderstanding or ignorance of the law").

courts have their own options for sanctioning debtors who deliberately misrepresent their financial affairs. Advocates should always emphasize the equitable nature of judicial estoppel.[90] Application of the doctrine is discretionary even when all elements are present.[91] The purpose of judicial estoppel is to protect innocent parties from severe prejudice and uphold respect for the judicial process. The purpose is not to create a shield for offensive creditor practices. If a debtor's omission of a claim from bankruptcy schedules had no tangible negative impact on any party or the bankruptcy system, judicial estoppel serves no purpose.

4. Judicial Estoppel and Claims for Equitable Relief and Recoupment

The unfair practice that judicial estoppel is designed to prevent is the concealment of assets that could have been liquidated to pay creditors. A debtor's legal claims that did not seek monetary relief do not fit this description. Therefore, courts should not apply judicial estoppel to claims for equitable relief, even when those claims were not listed in a debtor's bankruptcy schedules.[92] Occasionally claims for monetary damages and injunctive relief arose from the same set of facts. In these situations a court may apply judicial estoppel to some of the claims, but not to others. The court can direct the bankruptcy trustee to pursue the monetary claims while allowing the debtor to

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[90] New Hampshire v. Maine, 532 U.S. 742, 750 (2001); Ah Quin v. Cnty. of Kauai Dep't of Transp., 733 F.3d 267, 272 (9th Cir. 2013); *In re* An-Tze Cheng, 308 B.R. 448, 459 (B.A.P. 9th Cir. 2004), *aff'd,* 160 F. App'x 644 (9th Cir. 2005).

[91] Ah Quin v. Cnty. of Kauai Dep't of Transp., 733 F.3d 267, 272 (9th Cir. 2013) (court not bound to apply judicial estoppel if inadvertence or mistake shown, even though all elements of judicial estoppel otherwise present).

[92] Barger v. City of Cartersville, 348 F.3d 1289, 1297 (11th Cir. 2003) (debtor's injunctive relief claim for reinstatement "would have added nothing of value to the bankruptcy estate even if she properly disclosed it"); Grillo v. JPMorgan Chase & Co., 2014 WL 2442534, at *5-6 (D. Colo. May 30, 2014) (judicial estoppel does not apply to equitable actions); Hardee-Guerra v. Shire Pharms., 737 F. Supp. 2d 318, 331-332 (E. D. Pa. 2010) (plaintiff's claims for injunctive and declaratory relief had no value to bankruptcy estate, judicial estoppel applied only to claims for compensatory damages). Note that the broad definition of "property of the estate" in bankruptcy includes "all legal *or equitable* interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1) (emphasis added). Arguably, debtors should have to list claims for equitable relief in their bankruptcy schedules.

pursue the claims for injunctive relief.[93] For example, in employment litigation a plaintiff may seek job reinstatement and monetary damages in the same lawsuit. When defendants attempted to use judicial estoppel to dismiss these employment cases, courts have allowed the plaintiff to proceed with the reinstatement claim while the committing the monetary claims to the bankruptcy trustee.[94]

This exception for claims for equitable relief has ramifications for limiting judicial estoppel in the context of enforcement of deeds of trust and mortgages. Many forms of relief that borrowers seek in opposing foreclosure can fairly be characterized as equitable in nature. For example, judicial estoppel should not apply to the borrower's claims for rescission, even if estoppel applies to other affirmative monetary claims raised in the same action.[95] If none of the claims were disclosed in a prior bankruptcy, any standing and estoppel problems could be resolved by having the trustee contract with debtor's counsel to pursue the monetary claims on behalf of estate and the equitable claims on behalf of debtor. All claims could be restored to the debtor if the trustee later abandons any interest in the litigation or the debtor exempts the monetary recovery.[96]

Recoupment is an equitable remedy. To the extent that a borrower brings claims defensively, such as in challenging a lender's proof of claim in bankruptcy or as defendant in a proceeding brought by the lender, judicial estoppel should not apply unless the borrower's monetary claims exceed the amount of the debt.

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[93] Rouben v. Parkview Hosp., Inc. 2013 WL 359649, at *3-4 (N.D. Ind. Jan. 30, 2013) (under judicial estoppel trustee takes over monetary claims and debtor retains claims for declaratory and injunctive relief); Wheeler v. Florida Dep't of Corr., 2006 WL 2321114 (M.D. Fla. 2006) (rejecting judicial estoppel; trustee can pursue debtor's monetary claims, debtor can pursue claims for injunctive relief).
[94] Matthews v. Potter, 316 F. App'x 518, 524 (7th Cir. 2009) (judicial estoppel does not bar party from pursuing job reinstatement claim); Barger v. City of Cartersville, 348 F.3d 1289, 1297 (11th Cir. 2003); McKenna v. Healthtease, Inc., 2013 WL 1702639, at *6 (E.D. Pa. Apr. 19, 2013) (damages claim in employment action dismissed because plaintiff failed to substitute trustee, but allowing plaintiff to proceed with claims for injunctive relief); Pace v. Hurst Boiler & Welding Co., 2011 WL 97244, at *4 (M.D. Ga. Jan. 12, 2011) (judicial estoppel applied to plaintiff's monetary claims in employment action, but not to claims for injunctive relief).
[95] Frese v. Empire Fin. Servs., 725 F. Supp. 2d 130 (D.D.C. 2010).
[96] *Id.*

5. *Judicial Estoppel Based on the Debtor's Affirmative Statements in Bankruptcy Schedules*

Efforts to impose judicial estoppel appear most often when the debtor omitted something from bankruptcy schedules. The usual target is a cause of action that had arguably accrued when the debtor filled out the schedules but neglected to mention. In addition, creditors have attempted to impose judicial estoppel based on other content of bankruptcy schedules, including the debtor's affirmative statements. Bankruptcy schedules require that debtors identify creditors, describe the nature of their debts, state the amounts owed, and indicate whether the debts are "disputed." [97] In the mortgage context, lenders and servicers have pointed to all of these types of statements in bankruptcy schedules in their attempts to use judicial estoppel against borrower's claims.[98]

The moral is that bankruptcy debtors need to be careful about identifying creditors and amounts owed in schedules of debts, as well as designating lender claims as "undisputed." Listing a deed of trust debt on the form schedules as secured without any qualification may result in judicial estoppel of a rescission claim. A debtor contemplating rescission or other challenge to the validity of a security agreement should at a minimum list the secured status of the claim as "disputed"

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[97] Bankruptcy Official Form 6D.

[98] Ward v, ANS Servicing, LLC, __ F. App'x __, 2015 WL 1432982 (11th Cir. Mar. 31, 2015) (debtor stipulated to amount of monthly mortgage payment in bankruptcy filing, judicial estoppel bars debt collection action asserting creditor should be claiming different amount); Haddad v. Randall S. Miller Assocs. PC, 587 F. App'x 959 (6th Cir. 2014) (judicial estoppel applied to FDCPA claim asserting attempt to enforce invalid mortgage where in prior bankruptcy schedules debtor "admitted" validity of same mortgage); Cordero v. America's Wholesale Lender, 2012 WL 4895869, at *11 (D. Idaho Oct. 15, 2012) (inconsistent statements in schedules leading to judicial estoppel included that lender held secured interest in property and that debtor intended to "surrender the property to the bank"); Bullard v. Indymac Bank F.S.B., 2012 WL 4134839, at *7 (E.D. Mich. Sept. 18, 2012), *aff'd on other grounds*, 539 F. App'x 665 (6th Cir. 2013) (judicial estoppel bars borrower's postbankruptcy challenge to validity of mortgage; borrower aware of claim during pendency of bankruptcy, did not schedule claim as asset, and listed property as subject to valid mortgage). *But see* Hymas v. Deutsche Bank Nat'l Tr. Co., 2015 WL 273615 (D. Nev. Jan. 22, 2015) (naming wrong party as noteholder in bankruptcy schedules was not misuse of bankruptcy and does not preclude a post-bankruptcy challenge to authority to foreclose).

or specify that it is subject to a rescission claim.

One distinctly erroneous application of judicial estoppel has involved the official bankruptcy form known as the "Chapter 7 Individual Debtor's Statement of Intention."[99] Chapter 7 debtors must complete and file this form identifying property that secures scheduled debts. On the form the debtor can check off a box indicating an intention regarding each secured debt and the property that secures it. The only options listed on the form are: to "surrender" the property, to claim the property as exempt, to redeem the property, or to reaffirm the debt.[100] At servicers' insistence, certain courts have construed the debtor's checking off the "surrender" box to mean that the debtor agreed to a physical transfer of the property to the creditor and waived all future objections to the creditor's efforts to enforce the security interest.[101] In other words, by checking off the "surrender" box homeowners were essentially turning over the keys to their homes to lenders and waiving all defenses to foreclosure. Under this view, a homeowner's subsequent opposition to a foreclosure would be taking an inconsistent position and subject the homeowner to judicial estoppel.

This view is based on a misunderstanding of the term "surrender" in the context of the "Chapter 7 Statement of Intention." By electing the "surrender" option the debtor does not agree to turn over physical possession of the collateral property to the creditor. Instead, the debtor turns over his or her interest in the property to the trustee for potential administration for the benefit of the bankruptcy estate.[102] The trustee can choose to liquidate any asset so surrendered.

[99] Bankruptcy Official Form 8.
[100] 11 U.S.C. § 521(a) (2) (A).
[101] *See, e.g.,* Cordero v. America's Wholesale Lender, 2012 WL 4895869 (D. Idaho Oct. 15, 2012); Ibanez v. US Bank Nat'l Ass'n, 856 F. Supp. 2d 273 (D. Mass. 2012).
[102] *See, e.g., In re* Claflin, 249 B.R. 840, 848 n.6 (B.A.P. 1st Cir. 2000); Schilling v. Reid, 372 B.R. 1, 2 (Bankr. W.D. Ky. 2007) (noting that § 521(a) (4) "commands that a debtor 'surrender to the trustee all property of the estate' " and not to the creditor); *In re* Kasper, 309 B.R. 82 (Bankr. D. Colo. 2004); *In re* Lair, 235 B.R. 1, 59-76 (Bankr. M.D. La. 1999). *See generally* 4 COLLIER ON BANKRUPTCY ¶ 521.14 (referencing the saving clause of 11 U.S.C. § 521(a) (2)(C) which states that the completion of the form does not alter the debtor's rights with respect to real property, and noting the impact

But, more commonly, after liens on the property are subtracted from its value, there is no non-exempt interest of any value for the trustee to take over and liquidate for the benefit of the estate. If the trustee exercises reasonable business judgment and takes no action to liquidate the asset, the debtor retains the property once the estate is closed. The debtor is then free to assert legal claims related to the property.[103] A debtor does not take inconsistent positions by checking off the "surrender" option on the "Chapter 7 Statement of Intention" and later defending a foreclosure or exercising a right to rescind with respect to the designated property.[104]

IV. **Issue and Claim Preclusion Based on Bankruptcy Events**

Basic concepts of claim and issue preclusion apply in the bankruptcy context. Thus, the failure to object to a lender's proof of claim in a chapter 13 case could have claim preclusion consequences. This will be particularly true when the debtor actually litigates over aspects of the claim while in bankruptcy, has a chapter 13 plan confirmed, and pays on the claim over time. Similarly, a debtor's attacks on a party's authority to enforce the loan or a debtor's challenges to the amount owed on a claim while in bankruptcy can lead to conclusive determination on these issues. The California Court of Appeal recently addressed one of these situations in *Boyce v. T.D. Service Co.*[105] The court affirmed the trial court's dismissal of the plaintiff's challenges to a party's authority to foreclose because the plaintiff had raised similar arguments in the context of a failed challenge to the creditor's proof of claim in bankruptcy. The court gave preclusive effect to the bankruptcy court's determination of the validity of the creditor's right to enforce the loan.

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of 11 U.S.C. § 524(j), which contemplates mortgagors' continued payments on a mortgage after a chapter 7 case in which the debtor neither reaffirmed the debt nor redeemed).

[103] 11 U.S.C. § 554(c).

[104] 11 U.S.C. § 521(a)(2)(C) (designations in statement of intention generally do not alter the debtor or the trustee's rights with regard to the property described, with exception only for debts secured by personal property).

[105] 235 Cal. App. 4th 429 (2015).

Whether claim and issue preclusion will apply to certain determinations in bankruptcy depends on the nature of the action. Most courts hold, for example, that the bankruptcy court's granting of a motion for relief from the stay to allow a lender to proceed with a foreclosure under state law has no preclusive effect.[106] Decisions on allowance or disallowance of a creditor's proof of claim are more likely to have preclusive effect.[107] A bankruptcy court's order confirming a chapter 13 plan is entitled to *res judicata* treatment like any federal court judgment. Thus, if the confirmed plan provided for treatment of a pre-petition mortgage debt in a certain way, the debtor may face judicial estoppel and *res judicata* problems if the debtor later brings an action that poses a contrary legal theory about the status of the mortgage at the time of plan confirmation.[108]

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[106] Grella v. Salem Five Cent Sav. Bank, 42 F.3d 26 (1st Cir. 1994); *In re* Veal, 450 B.R. 897, 914 (B.A.P. 9th Cir. 2011).
[107] Siegel v. Federal Nat'l Mortg. Ass'n, 143 F.3d 525, 529 (9th Cir. 1998); *In re* Veal, 450 B.R. 897, 918 (B.A.P. 9th Cir. 2011).
[108] Covert v. LVNV Funding, LLC, 779 F.3d 242 (4th Cir. 2015) (res judicata applied to bar plaintiffs' FDCPA and state debt collection law claims asserting unlicensed debt buyer had attempted to collect debts it had no right to collect; plaintiffs had not objected to the debt buyer's claims in prior chapter 13 cases in which plans were confirmed); Bullard v. Indymac Bank F.S.B., 2012 WL 4134839, at *7 (E.D. Mich. Sept. 18, 2012), *aff'd on other grounds*, 539 F. App'x 665 (6th Cir. 2013) (judicial estoppel bars borrower's postbankruptcy challenge to validity of mortgage; borrower aware of claim during pendency of bankruptcy, did not schedule legal claim as asset, and listed property as subject to valid mortgage).

Helping Reverse Mortgage Non-Borrower Spouses[109]

Potentially thousands of elderly widows and widowers, whose spouses obtained reverse mortgages on the assurance that the spouse who was not listed as a borrower on the loan could remain in the home after the borrower-spouse died, are unaware of the special risks posed by these mortgages. Fraud perpetuated by brokers and originators pushed many spouses to sign away their ownership interest in the home so that the older spouse could qualify for the reverse mortgage or receive more proceeds from the loan. The non-borrower spouse rarely understood the consequence of this action. When the spouse who is the borrower on the loan dies, the non-borrowing spouse (usually the wife) is left widowed and facing foreclosure and eviction.

HUD, which oversees the federally insured Home Equity Conversion Mortgage ("HECM") reverse mortgage program, has long understood the risk these loans pose to non-borrower spouses. HUD has been sued several times by non-borrower spouses represented by AARP and Mehri & Skalet, PLLC for its failure to issue regulations, consistent with the HECM statute, to protect non-borrower spouses from eviction. The United States District Court found that the agency's regulation was contrary to the plain meaning of the HECM statute and ordered HUD to come up with a solution to protect non-borrower spouses currently at risk of foreclosure or already in foreclosure. After several false starts, HUD issued Mortgagee Letter 2015-15 on June 12, 2015, which provides the most realistic option to date for non-borrower spouses facing foreclosure after the death of a spouse. Lenders have the option to assign the loan to HUD if the loan and the non-borrower spouse meet certain requirements. Early assignment of the mortgage to the agency would satisfy the claim of the lender, and defer the due and payable status of the loan until the death of the non-borrower spouse. The agency previously changed the parameters of the HECM program to address the issue for future originations of HECM loans, those originated after August 2014.

Background

The reverse mortgage statute, 12 U.S.C. § 1715z-20(j), prohibits HUD from insuring HECMs unless the mortgage provides that the homeowner's obligation to satisfy the loan is deferred until the homeowner's death, the sale of the home or the occurrence of other

[109] This article was written by Sarah Mancini and Odette Williamson of the National Consumer Law Center.

events specified in regulations of the Secretary. The protections against displacement in subsection (j) extend to the homeowner's spouse even if he or she was not named on the loan.[110] That is, the death of a homeowner should not trigger the obligation to pay off the mortgage if there is a surviving non-borrowing spouse.

Contrary to the statute's mandate, for over two decades HUD has insured reverse mortgages which fail to protect the rights of non-borrowing surviving spouses. HUD's regulation, 24 C.F.R. § 206.27(c), states that the mortgage becomes due and payable in full when the mortgagor dies and the property is not the principal residence of at least one surviving mortgagor.[111] A mortgagor is defined as "each original borrower under a mortgage," excluding the successors or assigns of the borrower.[112] The statutorily mandated protections were also missing from the standard mortgage forms written by HUD for use by approved lenders. The standard HECM form note and mortgage (deed of trust) call the loan due and payable upon the death of the borrower and certain other conditions, regardless of whether there is a surviving non-borrowing spouse.[113] HUD issued insurance certificates to lenders who provided loans consistent with its regulations and guidance.

Though the agency has long understood the risk that non-borrowing spouses face, it has provided little in the way of substantive protections, and neither has it, until recently, sought to change its policy or regulation. In 2006 HUD recommended that non-borrowing spouses of prospective HECM borrowers receive counseling to understand the implications of the loan and risks posed by

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[110] 12 U.S.C. § 1715z-20(j) ("For the purposes of this subsection, the term "homeowner" includes the spouse of the homeowner.") See also *Bennett* v. *Donovan*, 4 F. Supp. 3d 5, 12 (D.D.C. 2013) ("Subsection (j) means what it says: the loan obligation is deferred until the homeowner's and the spouse's death.")

[111] The regulation also adds that the loan is "due and payable" if the home is not the principal residence of the mortgagor; and upon the mortgagor's failure to perform an obligation of the mortgage or occupy the property for more than 12 consecutive months. 24 C.F.R. § 206.27(c).

[112] 24 C.F.R. § 206.3.

[113] Handbook 4235.1 Rev-1, Appendix 1, Model Mortgage Form (Paragraph 9: Grounds for Acceleration of Debt).

quitclaiming their interest in the home to their spouse.[114] Subsequently, in 2011 HUD updated its counseling requirements to require that non-borrowing spouses attend counseling and sign the counseling certificate, thereby tacitly blessing this risky practice. As highlighted by the CFPB in its recent recitation of complaints received by the agency on reverse mortgages, counseling has been inadequate to address the risk of displacement.[115] Consumers submitted complaints saying that they were unaware that the younger non-borrowing spouse could lose the home if the older spouse dies first.[116] Others worry about their ability to remain in the home should the older spouse die first. The Bureau's report noted in general that older consumers and their families are "confused and frustrated by the terms and conditions of reverse mortgages."[117]

HUD's Prospective Fix

HUD fixed the problem prospectively for new HECMs originated after August 4, 2014 in Mortgagee Letter 2014-07. This mortgagee letter says that for new loans, the lender must take into account a non-borrowing spouse in calculating the loan terms and the loan will not come due and payable until the death of the borrower *and any spouse*. However, HUD failed to address in ML 2014-07 any remedy for non-borrower spouses dealing with a loan predating August 2014.[118]

Ongoing litigation in the D.C. District Court

HUD was pushed to address this long-neglected issue by several lawsuits alleging that HECM program regulations violated the Administrative Procedures Act, 5 U.S.C. §§ 551, et seq.[119] In *Bennett v. Donovan*, the United States District Court concluded that the HECM statute only permits HUD to insure reverse mortgages that come due

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[114] U.S. Dep't Hous. & Urban Dev., Mortgagee Letter 2006-25 (September 28, 2006); see also Mortgagee Letter 2011-31 (August 26, 2011).
[115] See Consumer Financial Protection Bureau, Office of Older Americans, *Snapshot of Reverse Mortgage Complaints: December 2011 – December 2014*, February 2015.
[116] Id.
[117] Id.
[118] U.S. Dep't Hous. & Urban Dev., Mortgagee Letter 2014-07 (April 25, 2014).
[119] Bennett v. Donovan, 797 F. Supp. 2d 69 (D.D.C. 2011); Plunkett v. Castro, 2014 WL 4243384 (D.D.C. August 28, 2014).

after the death of the homeowner-mortgagor and the spouse of the homeowner, regardless of whether the spouse is a mortgagor.[120] HUD's regulation, 24 C.F.R. § 206.27(c)(1), is contrary to plain meaning of the statute and invalid.[121] Subsequently, in *Plunkett v. Castro* (consolidated with the *Bennett* case under the case number 1:14-CV-326), the Court reaffirmed the holding of *Bennett* and weighed the options outlined by the agency to comply with the statutory mandate to protect plaintiffs and similarly situated surviving spouses from displacement.[122]

The primary avenue for relief that HUD created for the named plaintiffs in the *Plunkett* litigation is called the Mortgagee Optional Election ("MOE"). HUD created this option in a Determination on Remand it issued June 24, 2014. Under the MOE, a mortgagee (creditor) may elect to assign the plaintiffs' reverse mortgages to HUD *only if* certain criteria are met.

None of the named plaintiffs in *Plunkett* could satisfy the MOE criteria. The problem resides with one factor: the "principal limit test."[123] Most non-borrower spouses will fail this test unless (a) they were the same age or older than the borrowing spouse, such that their initial Principal Limit Factor would have been equal to or greater than that of the borrowing spouse, or (b) they can pay down the loan balance to the level it would be at now if they had been factored into the initial calculation of the loan amount. Scenario (a) is very unlikely, as most spouses were left off the loan in order to meet eligibility requirements (must be over age 62) or maximize loan proceeds because of the very fact that they were younger than the borrowing spouse. Scenario (b) will also be very difficult for a non-borrower spouse to satisfy (unless the age difference between the spouses was very small or not all available funds were withdrawn from the possible loan

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[120] Bennett v. Donovan, 4 F. Supp. 3d 5, 7 (D.D.C. 2013).
[121] Id. at 8.
[122] Plunkett v. Castro, 2014 WL 4243384 (D.D.C. August 28, 2014).
[123] The other criteria for assignment through the MOE include:

- Spouse was legally married to borrower at time of loan and remained married until borrower's death
- Home is spouse's principal residence from time of loan to the present
- Spouse has title to the property (or legal right to remain for life)
- Loan is not in default for any other reason than death of borrower
- No claims are outstanding that would invalidate the loan
- Principal balance cannot exceed the Maximum Claim Amount (value of the home at origination).

proceeds), as it would require a substantial upfront payment, often in the range of $10,000 to $40,000.

In a summary judgment brief HUD filed in *Plunkett*, HUD inadvertently opened up another avenue for relief for the plaintiffs. HUD took the position in its brief that because the regulation requiring foreclosure after death of a mortgagor (regardless of any resident spouse) was invalid as to the plaintiffs, the foreclosure timelines enshrined in 24 C.F.R. § 206.125 were not triggered for their loans. These foreclosure timelines are what require the lender to initiate foreclosure promptly (within six months of a triggering event) or begin to forfeit any interest accruing on the loan balance after missing this deadline. If the foreclosure timelines are not triggered by the death of a mortgagor while a spouse is still residing in the home, then the lender may simply delay foreclosure indefinitely (until some other triggering event) and assign the loan to HUD when it reaches 98% of the value of the home, as the lender is already authorized to do. The *Plunkett* court called this the "Trigger Inapplicability Decision (TID)." HUD later began calling it the "Hold Election" (or "HE" for short).

In its decision issued August 28, 2014, the D.C. District Court in *Plunkett* found that HUD's creation of the MOE Assignment program was not arbitrary and capricious.[124] However, the Court found that HUD's failure to offer as an explicit option in the Determination on Remand the other remedy that it acknowledged in its summary judgment brief, the "TID" (now called the Hold Election), was arbitrary and capricious.[125] The court remanded to HUD to consider extending the TID not just to the named plaintiffs in *Plunkett*, but to all similarly situated surviving spouses. The court described it as "unfathomable" that other spouses not participating in the lawsuit would be treated differently from the named plaintiffs.[126] However, in a puzzling turn, the court also denied without prejudice plaintiffs' motion for class certification.

Mortgagee Letter 2015-03

On January 29, 2015, HUD issued Mortgagee Letter 2015-03. In Mortgagee Letter 2015-03, HUD noted that it had considered the two options outlined in *Plunkett* – the Hold Election and the MOE Assignment – to address the non-borrowing spouse issue. The agency

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124 Plunkett v. Castro, 2014 WL 4243384 (D.D.C. Aug. 28, 2014).
125 *Id.*
126 *Id.*

dismissed the Hold Election, declaring that this option “when applied to the universe of mortgages involving non-borrowing spouses of borrowers imposes a financial risk to the insurance funds that is simply too great.”[127] Mortgagee Letter 2015-03, however, lacks any foundation for this conclusion. There is no discussion of the number of loans at issue; the number of surviving spouses potentially impacted; the cost of the proposed option as compared to its alternative; or a breakdown of the anticipated impact on the insurance fund. The agency did not provide or cite any data, information or independent analysis to back up its recommendation. Comments to the agency regarding its adoption of the MOE Assignment option indicated that lenders were confused as to the application of the principal limit test. On April 30, 2015, HUD revoked Mortgagee Letter 2015-03 and gave lenders the option of putting foreclosure on hold for 60 days without a financial penalty.

Mortgagee Letter 2015-15

HUD’s newly revised MOE Assignment, announced in Mortgagee Letter 2015-15, provides spouses of reverse mortgage borrowers with the most workable option to date to save their home from foreclosure and eviction. In Mortgagee Letter 2015-15 lenders now have the option to assign a loan to HUD if there is a surviving spouse living in the home, without requiring the spouse to pass the "Principal Limit Test" or "Principal Limit Factor Test" discussed above.[128] This was the biggest hurdle for non-borrowing spouses attempting to take advantage of this option under previous versions of the MOE. The non-borrowing spouse must still satisfy several criteria in order for the loan to be assigned to HUD. The most significant of these are:

- Spouse must have, or be able to obtain within 90 days following the death of the borrower, title or the legal right to remain in the home until her death;

- Spouse must have been married to the borrower at time of the loan closing (with an exception for same sex couples who could not legally marry) and must have been married at the time of borrower's death;

- The home must be spouse's principal residence; and

[127] U.S. Dep’t Hous. & Urban Dev., Mortgagee Letter 2015-03 (January 29, 2015).
[128] U.S. Dep’t Hous. & Urban Dev., Mortgagee Letter 2015-15 (June 12, 2015).

- If there has been a default on property taxes or homeowner's insurance, the spouse must cure any such default before the loan can be eligible for assignment.

In addition, the agency will not accept assignment of a mortgage if there are allegations or claims that would invalidate the HECM unless those claims have been judicially resolved in favor of the lender.

If the loan is assigned to HUD under the MOE Assignment option, the due and payable status of the loan will be deferred until the death of the spouse. Though the spouse is allowed to stay in the home, she will not receive any proceeds from the HECM. During the deferral period the spouse is obligated to pay taxes and insurance, maintain the property and meet the other requirements of the mortgage.

Advocates should keep abreast of important deadlines outlined in Mortgagee Letter 2015-15.

By the later of 120 days after the death of the borrower or 120 days after the effective date of the Mortgagee Letter (June 12, 2015), the lender must elect to take the MOE or exercise its contractual right to foreclose. Within 30 days after the election, the lender must notify the spouse and the borrower's estate of what election it has made. Within the 60 day period after an election of the MOE, the lender must review all criteria to ensure that the loan is eligible. If the loan is ineligible the deferral period will end and the lender will foreclose.

What Can Advocates Do to Help Non-Borrower Spouse Clients?

Advocates representing a non-borrower spouse at risk of foreclosure should take advantage of the newly amended MOE Assignment option offered in Mortgagee Letter 2015-15. If the MOE Assignment could work for your client, you can contact the reverse mortgage servicer and ask them to elect the MOE Assignment, explaining how your client meets all applicable criteria. Be aware the timeframe is very tight and the lender must elect the MOE Assignment by day 120. Advocates should also do outreach to find non-borrower spouses who may benefit from this program and help them navigate the criteria for assignment during the short window of time.

Even though your client may meet most of the eligibility requirements for the MOE Assignment, litigation may be necessary in cases where there is a default on taxes and insurance that cannot be cured within the required time frame, title or the right to remain in the home cannot be determined within the required time frame, or where a servicer fails to act quickly enough to meet all deadlines imposed by HUD for election of the option. There is also the possibility that some lenders may not elect to take the MOE Assignment. Advocates should push hard to get the lender or servicer to make the election and should assist with documentation and satisfaction of all criteria. With an MOE Assignment to HUD the lender will be made whole financially and should be indifferent to foreclosing or taking the MOE Assignment option. Threats of litigation, public pressure and media attention should be enough to convince a lender to take the MOE Assignment.

If the MOE Assignment is not a viable option for your client, experience to date suggests that if a surviving spouse sues HUD and obtains a judgement that HUD's regulation making the loan due and payable upon death of a mortgagor is invalid, then HUD will extend to the mortgagee the second option – the Hold Election, which allows the spouse to remain in the home until her death.

There are a number of legal claims advocates can include in an action against HUD.[129] The first and most critical is a claim under the Administrative Procedures Act, 5 U.S.C. §§ 551, et seq. ("APA"), arguing that HUD's regulation at 24 C.F.R. § 206.27(c)(1), which requires the loan be called due and payable upon the borrower's death, violates the HECM statute, 12 U.S.C. § 1720z-20(j), which requires protection for the spouse. The plaintiff is therefore entitled to a declaratory judgment that the regulation is invalid. This is a pure issue of law, and could be tackled on an early motion for partial summary judgment. Taking this claim one step further, the plaintiff can seek injunctive relief asking the court to require HUD to use its authority to ensure that the mortgagee will not be financially penalized for not foreclosing on the basis of the invalid regulation, provide the mortgagee an alternative means of payment other than foreclosing pursuant to the invalid regulation, and explain to the mortgagee that any claim for

[129] These potential claims, and litigation strategy issues, are covered in a webinar conducted by NCLC, available here: http://www.nclc.org/national-elder-rights-training-program/elder-abuse/part-ii-litigating-on-behalf-of-reverse-mortgage-surviving-spouses.html.

payment based on an improper foreclosure pursuant to the invalid regulation will be denied.

A surviving spouse could also include claims for breach of contract or reformation of the contract on the basis of mutual mistake. The first claim would assert that the spouse is an intended third party beneficiary of the HECM insurance contract, which is a three-party agreement between HUD, the lender, and the borrower. The terms of the HECM insurance are defined by the statute and regulation – there is no other insurance contract. Because the offending regulation is invalid, the insurance contract now does not include as a foreclosure trigger the death of a borrower where a surviving spouse continues to reside in the home. The latter claim involves the spouse (again as an intended third party beneficiary) seeking to reform the HECM mortgage itself based mutual mistake. The parties to the contract (lender and borrower) both intended the reverse mortgage to comply with federal law (see paragraph 17 of the Deed of Trust, which explicitly says the contract is governed by federal law and allows for severability of any provision that conflicts with federal law). Therefore, the contract should be reformed to reflect the intent of the parties, so that the loan does not become due and payable until the death or permanent relocation of the mortgagor *and any spouse*.

Finally, many surviving spouses have potential claims against the loan originator (and the current holder, as assignee) for fraud or misrepresentation. These claims arise when the loan officer made knowing or reckless misrepresentations to the borrower and spouse regarding the implications of taking out the loan in the name of only one spouse, such as assuring the non-borrower spouse that she would not face foreclosure so long as she lived in the home, or that her name could simply be "added to the loan" when she reached age 62. The fact that the loan officer stood to benefit financially (through origination fees and other charges) if the loan closed, and that the loan would not have gone through if the younger spouse had been included as a borrower, go toward establishing intent. There are a few caveats to bringing these claims. First of all, depending on the amount of time that has passed since origination, there may be statute of limitations issues. The spouse will also have to plead a factual basis for assignee liability in order to keep the current holder of the loan on the hook for the original lender's conduct. Helpful in this regard is the fact that reverse mortgages are not negotiable instruments[130] and thus the holder of the loan cannot claim to be a holder in due course. Finally, if the spouse pursues this kind of claim against the lender but also seeks to pressure HUD to offer the Hold Election (through an APA claim), any claim that could invalidate the mortgage (such as fraud) must be resolved in favor of the lender (eg, through dismissal with prejudice or a court order) before HUD will allow the lender to elect the Hold Election.

Conclusion

For widows and widowers who were left off a reverse mortgage loan taken out by their spouse, the risks are great. Without strong advocacy making use of a range of tools, these vulnerable seniors are likely to face imminent foreclosure and eviction. The National Consumer Law Center is available for individual case consultation related to these cases. Contact owilliamson@nclc.org or smancini@nclc.org for more information.

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130 The note is not for a sum certain and not due upon demand or at a set time. See U.C.C. § 3-104.

Supreme Court Rejects Lien Strip Off in Chapter 7 Cases[131]

The Supreme Court on June 1 has just held in *Bank of America, N. A. v. Caulkett*[132] that a wholly underwater mortgage cannot be stripped off and voided using Bankruptcy Code § 506(d) in a chapter 7 bankruptcy case. The decision should have little impact on consumer bankruptcy cases, since most courts (except those in the Eleventh Circuit) had previously held that mortgage strip off in chapter 7 was not possible, based on the Supreme Court's earlier decision involving a partially secured mortgage in *Dewsnup v. Timm*.[133]

The *Caulkett* holding is limited to chapter 7 cases, and the reasoning of the Court should not prevent consumer debtors from continuing to strip off wholly unsecured mortgages in chapter 13 cases. The vast majority of courts, and all Circuit Courts that have ruled on the matter (including the Ninth Circuit), have concluded that a wholly underwater mortgage may be provided for in a chapter 13 plan as an unsecured claim based on the application of § 506(a) and § 1322(b)(2).[134] These courts have relied on the language in the Supreme Court decision in *Nobelman v. American Sav. Bank*,[135] that in determining whether creditors are "holders of secured claims" that are entitled to protection from modification under § 1322(b)(2), a court must first look to § 506(a) for a valuation of the claim's secured and unsecured components. With no value supporting its claim based on the § 506(a) analysis, the holder of an underwater lien does not have a secured claim, and therefore the lien may be modified under § 1322(b)(2). The actual strip off and

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[131] This article was written by John Rao, Attorney at the National Consumer Law Center.
[132] Bank of Am., N.A. v. Caulkett, 135 S. Ct. 1995 (2015).
[133] 502 U.S. 410 (1992). The earlier *Dewsnup* decision and its impact on the modification of home secured mortgages in chapter 7 cases is discussed in NCLC's CONSUMER BANKRUPTCY LAW & PRACTICE § 11.2.1.2 (10th ed. 2012 with online updated revision).
[134] *In re* Schmidt, 765 F.3d 877 (8th Cir. 2014); *In re* Davis, 716 F.3d 331 (4th Cir. 2013); *In re* Zimmer, 313 F.3d 1220 (9th Cir. 2003); *In re* Lane, 280 F.3d 663 (6th Cir. 2002); *In re* Pond, 252 F.3d 122 (2d Cir. 2001); *In re* Dickerson, 222 F.3d 924 (11th Cir. 2000); *In re* Tanner, 217 F.3d 1357 (11th Cir. 2000); *In re* Bartee, 212 F.3d 277 (5th Cir. 2000); *In re* McDonald, 205 F.3d 606 (3d Cir. 2000); *see also* NCLC, CONSUMER BANKRUPTCY LAW & PRACTICE § 11.6.1.2.2.2.
[135] 508 U.S. 324 (1993).

avoidance of the mortgage in chapter 13 cases is not based upon § 506(d), but rather through the application of § 1322(b)(2) alone or in combination with § 1327(c).

Nothing in *Caulkett* undermines the reasoning supporting chapter 13 strip offs. The Court was careful to limit its discussion to the application of § 506(d), which again is not used in chapter 13 strip offs. Specifically, the limited holding in *Caulkett* is that "a debtor in a Chapter 7 bankruptcy proceeding may not void a junior mortgage lien under § 506(d) when the debt owed on a senior mortgage lien exceeds the current value of the collateral."[136]

The Court also distinguished its decision in *Nobelman*, stating that: "Nobelman said nothing about the meaning of the term 'secured claim' in § 506(d). Instead, it addressed the interaction between the meaning of the term 'secured claim' in § 506(a) and an entirely separate provision, § 1322(b)(2)."[137] This makes clear that the interplay between § 506(a) and § 1322(b)(2) in chapter 13 cases remains viable and will continue to support strip offs in chapter 13 cases. The Supreme Court was made aware in the briefing in *Calulkett* of the unanimous Circuit Court decisions permitting chapter 13 strip offs, and yet did not include dicta or any suggestion that these decisions were wrongly decided.

In rejecting the debtor's argument that the *Dewsnup* holding should be limited to partially secured liens, the Court stated that this distinction could result in some "arbitrary results" as only one dollar difference in value might prevent a strip off. However, the Court in *Caulkett* also noted that there are many provisions in the Bankruptcy Code that provide for this kind of "line-drawing," where a dollar difference can have a significant impact. The Court stated that it was appropriate for Congress to draw such lines in specific Code provisions, but not for the Court itself to do so in a provision such as § 506(d) that does not by its express terms refer to valuation or line-drawing. Again, chapter 13 strip offs rely upon § 506(a), where the line-drawing between a secured

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[136] *Caulkett*, 135 S. Ct. at 2001.
[137] *Id*. at 2000.

and unsecured claim based on the value of the collateral was clearly done by Congress in the specific words of the statute. Thus, *Caulkett* suggests that the potential dollar difference result in chapter 13 strip offs is appropriate, because the line-drawing was done by Congress.

Summaries of Recent Cases

Borrower may Complete Application within Reasonable Timeframe, even after Servicer Deadline; No Tender Required to Assert HBOR Claim Post-Foreclosure

Valbuena v. Ocwen Loan Servicing, __ Cal. App. 4th __, 2015 WL 3856542 (May 21, 2015): Under Civil Code section 2923.6, when a borrower submits a "complete application for a first lien loan modification," the lender may not conduct a foreclosure sale unless it first evaluates that application and provides an appeal period. An application becomes a "complete application" when "a borrower has supplied the mortgage servicer with all documents required by the mortgage servicer within the reasonable timeframes specified by the mortgage servicer." In *Valbuena*, the plaintiffs alleged that they received a letter from defendant Ocwen Loan Servicing on March 18, 2013, which invited them to submit an application for mortgage assistance. The letter specified a deadline for submission which had already expired when plaintiffs received the letter. Nevertheless, plaintiffs submitted application documents on March 21 and supplemented their application on March 23 following a conversation with an Ocwen representative. Although Ocwen declined to consider the application, and held the foreclosure sale as scheduled on March 25, the trial court sustained Ocwen's demurrer, reasoning that plaintiffs had failed to plead tender or an exception to the tender requirement.

This Court reversed for two reasons. First, the Court held that plaintiffs need not allege tender in order to plead a violation of Section 2923.6, reasoning that such a requirement would "completely eviscerate the remedial provisions of the statute." Second, the Court determined that plaintiffs adequately alleged submission of a complete application, because their allegations were sufficient to raise a factual issue as to whether the timeframe specified by Ocwen was "reasonable" as required under Section 2923.6.

HBOR Interim Fees Available after Preliminary Injunction

Monterossa v. Super. Ct., __ Cal. App. 4th __, 2015 WL 3653319 (June 12, 2015): HBOR explicitly made attorney's fees recoverable based on obtaining injunctive relief: "A court may award a prevailing borrower reasonable attorney's fees and costs in an action brought pursuant to this section. A borrower shall be deemed to have prevailed for purposes of this subdivision if the borrower obtained injunctive relief or was awarded damages pursuant to this section." CC 2924.12(i). The statute does not distinguish between a preliminary injunction and a permanent injunction. Here, borrowers brought HBOR claims against their servicer and obtained a preliminary injunction to stop the foreclosure sale of their home. Accordingly, the court awarded appropriate attorney's fees, relying on the plain language in § 2924.12.

California's Consumer Credit Reporting Agencies Act: Reporting of Deficiency after Foreclosure

Kuns v. Ocwen Loan Servicing, LLC, __ F. App'x __, 2015 WL 2405422 (9th Cir. May 21, 2015). Borrower brought claim alleging that Ocwen violated the California Consumer Credit Reporting Agencies Act when it reported a deficiency resulting from a foreclosure sale to credit reporting agencies, when borrower had no personal liability for the deficiency because the property was bought with a purchase money mortgage and sold through a nonjudicial foreclosure. The CCRAA imposes an obligation not to report information that a servicer knows or should know is incomplete or inaccurate. CCRAA § 1785.25(a). The trial court dismissed borrower's complaint, holding that Ocwen had no affirmative duty to report that the deficiency could not be collected. The appellate court applied the rule that "furnishers of credit information such as Ocwen not only refrain from making any reports that are obviously wrong or missing crucial data, but also that the reports not contain information that is materially misleading." Because the protection from post-foreclosure personal liability "is complete and nonwaivable," borrower stated a claim under the CCRAA. Servicer's reporting of borrower's discharge of the deficiency in bankruptcy, by contrast, was neither incomplete nor inaccurate. The court affirmed in part, and reversed in part, the decision by the trial court.

Valid Contract, Conversion, SPOC and UCL Claims; Servicer Conduct Not So Extreme As To Support IIED Claim; FDCPA Claim Dismissed

Dowling v. Bank of Am., N.A., 2015 WL 3454563 (E.D. Cal. May 29, 2015). A breach of contract claim requires a contract, plaintiff's performance or excuse for failure to perform, breach by defendant, and resulting damage to plaintiff. Borrower alleged that she negotiated an Offer of Partial Claim and Agreement with the servicers and made three payments under its terms. Borrower alleged that servicers then breached the agreement by wrongfully claiming she was in arrears, leading to an NOD on the property. The court found that borrower had alleged all elements of a contract claim. The servicers' motion to dismiss the contract claim was denied.

To make a claim of conversion, a borrower must allege (1) ownership or right to possession of the property at the time of the conversion; (2) servicer's conversion by a wrongful act or disposition of property rights and; (3) damages. Borrower pointed to the three payments made, which were never acknowledged or credited toward her loan. The court distinguished case law relied on by servicers, and denied the motion to dismiss borrower's conversion claim.

The elements of a claim for intentional infliction of emotional distress include: (1) outrageous conduct by the defendant; (2) intended to cause or recklessly disregarded the probability of causing emotional distress; leading to (3) severe emotional suffering; (4) that was actually and proximately caused by defendant's conduct. Borrower alleged as tortious conduct the servicers having passed her from one representative to another, requiring her to resubmit documents, refusing to acknowledge the agreement or her payments made pursuant to it, and misstating the balance she owed. The court held that such conduct was not "so extreme as to exceed all bounds of that usually tolerated in a civilized community.” The servicers’ motion to dismiss the IIED claim was granted.

Borrower complained under the FDCPA that it had instructed servicers to communicate only with a designated third party, but had been ignored. A party cannot be liable for violation of the FDCPA unless they fall within the Act’s definition of “debt collector.” The court credited servicers’ counter argument that they were not “debt collectors” under the FDCPA. The servicers’ motion to dismiss the FDCPA claim was granted.

A borrower who requests a foreclosure prevention alternative is to be provided with a single point of contact (SPOC) by the servicer. Borrower alleged she was passed between as many as sixteen different servicer representatives who continually denied her requests for assistance. The servicer pointed to documentation in the record of affirmative outreach by its agents, but the court found borrower’s allegations sufficient to state a claim. Servicers’ motion to dismiss the SPOC claim was denied.

Under the UCL, borrowers may make claims based on unlawful activity or practices that violate legislatively stated public policy, even if the practice is not technically prohibited by statute. A UCL claim must demonstrate: (1) lost money or property that is (2) caused by the unfair competition. The court noted that borrower had made out claims for breach of contract, conversion and HBOR violations. “Therefore, Plaintiff has alleged an economic injury resulting from alleged unlawful conduct.” Servicers’ motion to dismiss the UCL claim was denied.

Valid SPOC Claim; Failure to Allege Complete Application

Gonzales v. Wells Fargo Bank, N.A., 2015 WL 3429034 (N.D. Cal. May 27, 2015). A borrower who requests a foreclosure prevention alternative is to be provided with a single point of contact (SPOC) by the servicer, including a “direct means of communication” with that SPOC. Borrower alleged that she had requested but not received a SPOC. The court noted that an allegation of an application for a loan modification amounts to a request for “a foreclosure prevention alternative” and is sufficient to state a claim under 2923.7. Wells Fargo’s motion to dismiss the SPOC claim was denied.

Borrower in her second amended complaint again failed to allege that she ever submitted a complete application. Wells Fargo’s motion to dismiss the 2923.6 claim was granted.

Valid Dual Tracking, 2923.55, SPOC, and UCL Claims

Major v. Wells Fargo Bank, N.A., 2015 WL 2449516 (S.D. Cal. May 22, 2015). Servicers may not file an NOD until 30 days after contacting the borrower in person or by telephone to assess the borrower’s financial situation and explore foreclosure alternatives. Borrower alleged that Wells Fargo failed to exercise due diligence in trying to reach him by telephone and/or mail. The court rejected servicer’s attempt to rest on a bare declaration of compliance with the requirements of sec. 2923.55, and declined to consider evidence not in the record regarding prejudice and whether borrower’s home had not yet been sold. Wells Fargo’s motion to dismiss the 2923.55 claim was denied.

Once a borrower has submitted a complete loan modification application, HBOR prohibits a servicer from moving forward with the foreclosure process. Borrower alleged that servicer noticed a sale on the property while their loan modification was pending. Wells Fargo pointed the court to non-record evidence pertaining to default on a prior modification, in which case CC 2923.6 would not apply. The court declined to consider unrecorded evidence not in the record (but issued an unusual “Cautionary Note” to their counsel about proceeding “without a non-frivolous argument”). Wells Fargo’s motion to dismiss the dual tracking claim was denied.

A borrower who requests a foreclosure prevention alternative is to be provided with a single point of contact (SPOC) by the servicer, including a “direct means of communication” with that SPOC. Borrower alleged that she had requested but not received a SPOC. Servicer responded that borrower did not request a SPOC. The court observed that “the statute isn't triggered by a request for a single point of contact; it's triggered by a request for a foreclosure prevention alternative.” Wells Fargo’s motion to dismiss the SPOC claim was denied.

Borrowers’ UCL claims based on the above HBOR violations also survived Wells Fargo’s motion to dismiss.

HBOR Protections Avoided Where Servicer Foreclosured on Second Lien; Promissory Estoppel and Negligence Claims Survive Summary Judgment

Rijhwani v. Wells Fargo Bank, N.A., 2015 WL 3466608 (N.D. Cal. May 30, 2015). HBOR’s protections apply only to foreclosures of first liens on owner-occupied, one-to-four unit properties. Borrowers had two loans and servicer foreclosed on the second, junior lien. The court granted Wells Fargo’s motion for summary judgment on borrowers’ dual tracking and SPOC claims under HBOR.

To state a claim for promissory estoppel, borrowers must show that a servicer promised a benefit and went back on that promise, and that the borrower detrimentally relied on that promise. Borrowers submitted nine loan modification applications on their first loan over a period of years. Wells Fargo asserted that it did in fact fulfill any promises made, and denied other applications as incomplete. The court engaged in close review of the factually complex record. Borrowers received repeated and conflicting requests from servicer for a wide range of documentation, and received denials based on alleged incompleteness sometimes before the submission deadline had passed. The court denied Wells Fargo’s motion for summary judgment on borrowers’ claim based on promissory estoppel.

The elements of a claim for negligence include: (1) the existence of a duty to exercise due care; (2) breach of that duty; (3) causation; and (4) damages. Borrowers alleged that Wells Fargo mishandled their loan modification application. The court rejected servicer’s claim that it owed borrowers no duty of care. Servicer’s motion for summary judgment on borrowers’ negligence claim was denied.

Valid Fraud Claim; ECOA Notice Claim Does Not Require Showing of Discrimination

Banks v. JPMorgan Chase Bank, N.A., 2015 WL 2215220 (C.D. Cal. May 11, 2015): Fraud demands specific pleading of: 1) a misrepresentation; 2) defendant's knowledge that the misrepresentation is false; 3) defendant's intent to induce borrower's reliance; 4) the borrower's justifiable reliance; and 5) damages. Borrower alleged that JP Morgan represented to her that she was eligible for HAMP, and that it had not received all of the documentation necessary to determine her eligibility, when it was aware from the start that she was ineligible because her loan balance exceeded the $729,750 cap for eligibility. She alleged that the servicer, knowing that further documentation was unnecessary, intended to deceive her by inducing her to believe that it was working on a loan modification, as it engaged in dual tracking and caused her to incur default fees. Borrower alleged that she reasonably relied by attempting to participate in the HAMP process, including by submitting materials, and that she incurred damages in the form of default fees and reduced equity. The court rejected servicer's claim that the pleading was not sufficiently specific, and disregarded its effort to dispute the facts, which must be viewed in the light most favorable to the plaintiff. Chase's motion to dismiss Borrower's fraud claims was denied.

The Equal Credit Opportunity Act (ECOA) requires lenders to provide credit applicants with a determination within 30 days of receiving applicant's request. The lender must also explain reasons for any adverse actions against the applicant. This second requirement only applies if applicant is not delinquent or in default. Here, Borrower's complaint had been dismissed with leave to amend on the basis that ECOA required a showing of discrimination. The court reviewed the statute and legislative history to find that Congress required lenders to describe their reasons regarding all denials of credit, without regard to applicant's membership in a protected class, in order to serve the legislation's antidiscrimination purpose. The court denied the servicer's motion to dismiss borrower's ECOA claim.

Wrongful Foreclosure; UCL Pleading Requirements; Tender Not Required Under 2923.5

Burke v. JPMorgan Chase Bank, N.A., 2015 WL 2198319 (N.D. Cal. May 11, 2015): Borrowers brought wrongful foreclosure claim alleging that Chase had retained no beneficial interest in the DOT which had been sold by Washington Mutual to a mortgage-backed securities trust, prior to Chase's purchase of that bank. As a result, "WaMu was no longer the mortgagee when JP Morgan purchased its assets." These facts "render plausible the possibility that Defendants lack standing to foreclose on the mortgage." Chase's motion to dismiss the claim for wrongful foreclosure was denied.

A claim of fraud demands specific pleading of: 1) a misrepresentation; 2) defendant's knowledge that the misrepresentation is false; 3) defendant's intent to induce borrower's reliance; 4) the borrower's justifiable reliance; and 5) damages. The UCL makes unlawful practices that violate legislatively stated public policy, and prohibits practices that are "immoral, unethical, [or] oppressive." Borrowers alleged that statements by Chase in the notice of default and election to sell under deed of trust were knowingly false because the bank knew that it was not a valid beneficiary of their loan. The borrowers also brought a claim under the UCL based on the same alleged fraud. The court rejected "bare assertions" that that the servicer "lacked reasonable grounds for belief" in the foreclosure documents. "There are no allegations that Defendants did not act in good faith in purchasing WaMu's assets, and there are no facts explaining why JPMorgan should have known that WaMu lacked an interest in Plaintiffs' loan." The motion to dismiss the fraud and UCL claims were granted by the court.

A servicer may not record a notice of default (NOD) until 30 days after contacting, or diligently attempting to contact, the borrower to discuss alternatives to foreclosure. CC 2923.5. To set aside a foreclosure sale, a borrower must generally "tender" (offer and be able to pay) the amount due on their loan. Borrowers alleged that they were never contacted by a legitimate mortgage servicer, because "no defendant was a legitimate mortgagee[.]" JP Morgan responded that the claim must fail because borrowers did not assert that they tendered the loan amount due. But tender is not required for a claim under CC 2923.5.Furthermore, a borrower need not tender where their claim attacks the validity of the debt. The court denied JP Morgan's motion to dismiss borrower's CC 2923.5 claim.

Pleading Requirements Under Fraud Statute of Limitations; Valid Contract, Promissory Estoppel, Good Faith & Fair Dealing, Negligence Claims; UCL Pleading Requirements

Cruz v Aurora Loan Services, 2015 WL 2089963 (N.D. Cal. May 5, 2015): An action for fraud must be brought within three years. To be excused from the statute of limitations via the discovery rule, a borrower "must specifically plead facts to show (1) the time and manner of discovery and (2) the inability to have made earlier discovery despite reasonable diligence." The borrowers negotiated with Aurora for a loan modification; they were informed of payments that had to be made in order for them to qualify, and they made them. Servicer then denied borrowers' application in September 2011; borrowers did not file this action until December 2014 - more than three years later. Borrowers alleged that they did not immediately understand that the denial of their application was in error, but admitted that they did discover this fact within the relevant statute of limitations. Borrowers did not clarify the details of or excuse their late discovery that they qualified for Aurora's loan modification. The court granted Aurora's motion to dismiss the borrowers' intentional misrepresentation and false promise claims.

A breach of contract claim requires a contract, plaintiff's performance or excuse for failure to perform, breach by defendant, and resulting damage to plaintiff. To state a claim for promissory estoppel, borrowers must show that a servicer promised a benefit and went back on that promise, and that the borrower detrimentally relied on that promise. Aurora argued that no contract or promise was sufficiently alleged because the servicer retained the discretion to determine if the borrowers qualified, and Aurora told them they did not qualify. But according to the borrowers' complaint, the servicer informed them that, if they qualified for modification of their loan, that modification would then be conditioned on their making an initial payment and then three subsequent monthly payments. They borrowers submitted their application and were then asked to make the payments, which they did. They alleged that they would not have had to make any payments unless Aurora first determined that they qualified for a loan modification. The court denied the servicer's motion to dismiss the breach of contract and promissory estoppel claims. For the same reason, the court denied the servicer's motion to dismiss the implied covenant of good faith and fair dealing claim.

The elements of a claim for negligence include: (1) the existence of a duty to exercise due care; (2) breach of that duty; (3) causation; and (4) damages. Borrowers alleged that Aurora mishandled his loan modification application. The court rejected the servicer's claim that it owed the borrowers no duty of care, based on *Alvarez*. Aurora's motion to dismiss borrowers' negligence claim was denied.

The unfair prong of the UCL makes unlawful practices that violate legislatively stated public policy, even if the practice is not technically prohibited by statute. It also prohibits practices that are "immoral, unethical, [or] oppressive." Unlawful prong claims are based on a violation of an underlying statute, but may be brought regardless of whether that underlying statute provides a private right of action. The court rejected Aurora's assertion that borrowers suffered no economy injury unrelated to their loan arrearages and legal expenses. In their unlawful claim, however, borrowers point to CC 2923.6 and 2923.55, but include no factual allegations of HBOR violations elsewhere in their complaint. Similarly, the court was unable to determine the content of borrowers' specific allegations of any unfair business practices. The court granted servicer's motion to dismiss the UCL claims.

Complete Application; Charging of Late Fees Permitted Under 2924.11; Pleading Requirements for CC 2924.17 Claims; Valid 2923.55 Claim

Davis v. U.S. Bank, N.A., 2015 WL 2124938 (C.D. Cal. May 6, 2015): Once a borrower has submitted a complete loan modification application, HBOR prohibits a servicer from moving forward with the foreclosure process. Borrower alleged that U.S. Bank failed to acknowledge or appropriately respond to his loan modification application, instead repeatedly insisting on resubmission of documents while charging him late fees. The court rejected servicer's argument that borrowers' complaint did not sufficiently allege, and contradicted, the submission of a "complete" application. U.S. Bank's motion to dismiss the dual tracking claim was denied.

CC 2924.11(f) provides that "[t]he mortgage servicer shall not collect any late fees for periods during which a complete first lien loan modification application is under consideration or a denial is being appealed, the borrower is making timely modification payments, or a foreclosure prevention alternative is being evaluated or exercised." Borrowers' complaint alleged only charging, but not collection, of late fees. The court agreed with servicer's statutory construction argument that the statute did not bar the charging of fees. US Bank's motion to dismiss the CC 2924.11 claim was granted.

Servicers may not record a document related to foreclosure without ensuring its accuracy and that it is supported by "competent and reliable evidence." Before initiating foreclosure, a servicer must substantiate borrower's default and servicer's right to foreclose. Civ.Code § 2924.17. Borrowers alleged the NOD falsely represented that US Bank was unable to contact them to discuss alternatives to foreclosure. The NOD attached to the complaint, however, did not contain the language at issue. US Bank's motion to dismiss the 2924.17 claim was granted.

Under CC 2923.55, a servicer may not record a notice of default (NOD) until 30 days after contacting, or diligently attempting to contact, the borrower to discuss alternatives to foreclosure. The court declined U.S. Bank's invitation to infer from statements in the complaint about communication between the parties that foreclosure alternatives were discussed or that the bank offered a meeting to discuss these alternatives. The court also rejected the servicer's argument that language in the NOD Declaration referencing the requirements of 2923.55 should suffice to counter the allegations of non-compliance in complaint. The motion to dismiss the CC 2923.55 claim was denied.

Statute of Limitations; Tender Requirements

Gilliland v Chase Home Finance, LLC., 2015 WL 2345404 (E.D. Cal. May 13, 2015). The statute of limitations in California is four years for claims of breach of contract, breach of the covenant of good faith and fair dealing, as well as for false promise (UCL). Servicer argued that borrower's claims were filed outside of the statute of limitations, measured from the date when borrower first learned (via a call from a collection agency) that Chase was not honoring the terms of the loan modification. The court suggested that while the borrower "may have regarded these statements and the letter as an anticipatory breach" and seek immediate relief, she chose not to by continuing timely performance under the terms of the TPP and loan modification. Accordingly, the cause of action did not accrue until Chase conducted the foreclosure sale in 2011, just under three years before the complaint was filed. Servicer's motion to dismiss the claims for breach of contract and breach of the covenant of good faith and fair dealing, as well as the UCL claim, was denied.

In making a claim for wrongful foreclosure to set aside a sale, the party must have tendered or be excused from tendering the amount of the debt. Servicer argued for dismissal based on the borrowers' failure to allege tender of the amount owed. Borrower's complaint alleged that under the loan modification she was no longer in default. The court noted that among the exceptions to the tender requirement is where a borrower challenges the validity of the default and the servicer's contractual authority to foreclose in light of the alleged loan modification agreement. The court denied servicer's motion to dismiss the wrongful foreclosure claim.

The statute of limitations for fraud claims is four years. Borrower alleged that she relied on servicer's ongoing assurances that, although it would not honor the terms of the TPP and modification, she was still being considered for a modification and it would not foreclose. Because these promises were not proven false until the eventual foreclosure sale, the claim was timely filed within four years of the sale. Servicer's motion to dismiss the intentional misrepresentation claim was denied.The statute of limitations for negligence claims is two years. Borrower's complaint alleges that servicer failed to exercise due care in relationship to her loan modification, but the alleged was clearly past the statute of limitations, even applying the discovery rule. The court granted servicer's motion to dismiss borrower's negligence claim.

Claims Dismissed for Failure to Plead Material Change in Circumstances (Dual Tracking) or Damages (UCL, Negligence); Viable SPOC Claim

Greene v. Wells Fargo Bank, N.A., 2015 WL 2159460 (N.D. Cal. May 7, 2015). Once a borrower has submitted a complete loan modification application, HBOR prohibits a servicer from moving forward with the foreclosure process. These protections do not apply to borrowers who submit multiple applications, unless the borrower experienced a material change in financial circumstances and documented and submitted that change to their servicer. Borrower worked with Wells Fargo on a loan modification agreement over a period of years. After her application was denied and the bank recorded an NOD, borrower contacted Wells Fargo and requested a SPOC, alleging that a change in her financial circumstances warranted further review of her application. The bank requested that she submit further documentation. In the midst of these ongoing negotiations, the bank recorded a notice of trustee sale. Borrower's complaint had been dismissed for failure to allege any material change in her financial circumstances; her FAC asserts that there was such a material change without any factual support. The dual tracking claim was dismissed on this ground. While Wells Fargo also pointed to the request for more documentation as proof that borrower's application was not complete, "whether and when her application was complete is a factual question that the Court may not determine on a motion to dismiss."

A borrower who requests a foreclosure prevention alternative is to be provided with a single point of contact (SPOC) by the servicer, including a "direct means of communication" with that SPOC. Borrower alleged that she had requested but not received a SPOC. Wells Fargo's motion to dismiss the SPOC claim was denied.

Under the UCL, plaintiffs may bring claims based on unlawful activity or practices that violate legislatively stated public policy, even if the practice is not technically prohibited by statute. A borrower bringing a UCL claim must show: (1) lost money or property that is (2) caused by the unfair competition. Borrower's complaint fails to allege damages; the date set for the trustee sale has passed and the complaint does not allege that any sale occurred. Wells Fargo's motion to dismiss the UCL claim was granted by the court.

The elements of a claim for negligence include: (1) the existence of a duty to exercise due care; (2) breach of that duty; (3) causation; and (4) damages. Borrower alleged that Wells Fargo mishandled her loan modification application. Because the borrower failed to allege any damages caused by any alleged breach, the court granted the bank's motion to dismiss the negligence claim.

HOLA Preemption Not Found Where Claim is Based on National Bank's Own Conduct

Pimentel v. Wells Fargo, N.A., 2015 WL 2184305 (N.D. Cal. May 7, 2015). Some state laws may be preempted by federal banking laws such as the Home Owner Loan Act (HOLA), which regulates federal savings associations. Borrower asserted that Wells Fargo negligently delayed and mishandled her loan modification application. The bank moved to dismiss the borrower's claim as preempted by HOLA, pointing out that borrower's loan originated with World Savings Bank. After careful review of conflicting developing case law, the court ruled that HOLA preemption did not extend to claims against a national bank based on its own conduct that post-dates its merger with a federally-charted savings bank. Wells Fargo's motion to dismiss was denied.

Viable 2924.17 Claim; Materiality Standard

Rahbarian v. JP Morgan Chase Bank, N.A., 2015 WL 2345395 (E.D. Cal. May 14, 2015). Servicers may not record a document related to foreclosure without ensuring its accuracy and that it is supported by "competent and reliable evidence." Here, the borrower alleged that ownership of borrower's mortgage from Washington Mutual was transferred to certificate holders before WaMu's transfer of assets to Chase. Accordingly, borrower alleged that JP Morgan Chase CC 2924.17 when its representative signed the DOT even though it did not hold the deed of trust and was not the beneficiary. The court agreed with borrower that servicer violated 2924.17 by signing the NOD and notice of trustee sale without ensuring their accuracy. Under any of the competing standards for "materiality" under 2924.12, borrower's allegations here - that he should have been eligible for an available loss mitigation program - are sufficient. The court denied JP Morgan's motion to dismiss.

Viable SPOC Claim; Dual Tracking Claim Pleading Requirements

Villacis v. Ocwen Loan Servicing, LLC, 2015 WL 2227913 (N.D. Cal. May 12, 2015): A borrower who requests a foreclosure prevention alternative must be provided with a single point of contact (SPOC) by the servicer, including a "direct means of communication" with that SPOC. Borrower encountered multiple servicer representatives with different and contradictory information. Rejecting the servicer's contention that the complaint failed to allege any violation under HBOR, the court denied servicer's motion to dismiss the SPOC claim.

HBOR prohibits a servicer from moving forward with the foreclosure process - with respect to first liens on owner-occupied, one-to-four unit properties - once a borrower has submitted a complete loan modification application. Borrower alleged that servicer promised a modification while repeatedly requesting documentation that she had already provided. Servicer countered that (1) the complaint failed to allege that the mortgage was a first lien mortgage, (2) did not include information as to the actual date that borrower submitted a complete application, as to her claim under CC 2923.6, and (3) did not allege that Ocwen was a low-volume servicer to state a claim under CC 2924.18. For those reasons, the court granted servicer's motion to dismiss the dual tracking claim.

Viable Contract, Good Faith & Fair Dealing and Promissory Estoppel Claims; Good Faith & Fair Dealing Claim Does Not Follow to Transferee Servicer

Randell v. Flagstar Bank FSB, 2015 WL 2159595 (E.D. Cal. May 7, 2015). A breach of contract claim requires a contract, plaintiff's performance or excuse for failure to perform, breach by defendant, and resulting damage to plaintiff. To state a claim for promissory estoppel, borrowers must show that a servicer promised a benefit and went back on that promise, and that the borrower detrimentally relied on that promise. Borrower, working on a loan modification, filed for bankruptcy. Servicer negotiated with borrower on a TPP, and borrower performed under that agreement, including making payments. Servicer then informed her it would no longer be honoring the modification agreement, and later transferred the loan servicing to Green Tree, which also did not honor the modification. Servicer denied the existence of a contract, but the court found the allegations in the complaint sufficient to state a claim. The motion to dismiss borrower's contract and promissory estoppel claims was denied.

Every contract contains an implied covenant of good faith and fair dealing, "meaning that neither party will do anything which will injure the right of the other to receive the contract's benefits." Servicer's allegation that no such cause of action existed in California was rejected by the court. Flagstar's motion to dismiss borrower's good faith and fair dealing claim was denied.

Flagstar also sought judicial estoppel against borrower for failing to mention these claims as part of her bankruptcy case. The court declined. Claims regarding the 2013 breach of TPP could not be included in her 2012 Chapter 13 case, and the borrower scheduled the claim in her most recent bankruptcy petition. Even though the borrower should have updated the schedule in the 2012 Chapter 13 case, the case was later dismissed. The servicer alleged no facts indicating that the borrower gained an unfair advantage by failing to update the Chapter 13 schedule.

With respect to Green Tree, the court found that Green Tree is bound by the loan modification agreement between Flagstar and the borrower, and Green Tree breached the agreement by failure to honor the loan modification. However, the court granted Green Tree's motion to dismiss borrower's good faith and fair dealing claim because the facts alleged on that claim were premised solely on Flagstar's misconduct, not Green Tree's own actions.

Recent Regulatory Updates

MHA Handbook v. 4.5 (June 1, 2015)

Generally, Version 4.5 of the Handbook includes revisions to existing sections of Version 4.4 of the Handbook that have been issued in Supplemental Directives with effective dates after the publication of Version 4.4 of the Handbook and as of the date of this Supplemental Directive. Version 4.5 of the Handbook incorporates and supersedes in their entirety Supplemental Directives 14-01, 14-02, 14-03, 14-04, 14-05, 15-01, 15-02 and 15-04.

Mortgagee Letter 2015-15 (June 12, 2015)

For a detailed overview of the Mortgagee Letter, please see the non-borrowing spouse reverse mortgage article in this newsletter.

PLI Training: Foreclosure Litigation – Real World Solutions That Work For Both Sides 2015 (July 14; Free)

Register here (choice between live in San Francisco and webcast options).

Why You Should Attend

This substantive training provides an overview of:

- Ways to avoid foreclosure litigation by resolving disputes before filing suit, with the commentary of industry leaders representing both borrowers' and the servicers' perspectives;
- Foreclosure litigation and where there is common ground - which arguments help your case, which do not add anything to it, and which actually hurt your client's chances of a favorable resolution from both "sides"; and
- A summary of recent decisions and developments regarding the California Homeowner's Bill of Rights and the Consumer Financial Protection Bureau's Loan Servicing Rules.

The half-day training assumes familiarity with the basics of non-judicial foreclosures in California, but practitioners at all experience levels will benefit from this training. The panelists are noted experts in mortgage servicing, consumer and housing law who will cover a broad range of topics in foreclosure avoidance and litigation with real-world examples.

What You Will Learn

- Loss mitigation options for homeowners
- Foreclosure litigation perspectives from attorneys representing both borrowers and lenders
- Litigation strategies in foreclosure cases
- New laws and cases affecting foreclosure mortgage servicing litigation

Who Should Attend

Practitioners who want to gain a deeper understanding of the foreclosure process in California, as well as attorneys looking for tools to represent their clients in foreclosure cases. The sessions will address issues pertinent to those new to foreclosure litigation, plaintiff or defense side, as well as experienced practitioners.