

**BANKRUPTCY FILING (CHAPTERS 7 AND 13)
AND ITS EFFECT UPON THE FORECLOSURE PROCESS**

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September, 2001[©]

Bankruptcy filings are once again on the rise. The Administrative Office of the United States Courts has indicated that during the second quarter of the year 2001, the number of bankruptcy filings have risen 24.5% over the same period a year ago. This makes this the highest three month period ever. Filings are now on track to surpass the record breaking year of 1998 when 1,442,549 new cases were filed.

In the first six months of 2001, there was an increase of 21% over the first half of 2000. This may or may not have been due to the considerable attention being given to HR333 and S420 which are now pending in Congress. These bills propose significant changes to the bankruptcy code, that according to debtor bankruptcy attorneys and consumer groups, will adversely affect the individual consumer.

Since it has been widely predicted that some form of relief will pass, debtor's attorneys have been actively marketing these services which may account for the increase in filings. Given the proliferation of filings, it is necessary to understand how a filing under Chapter 7 or Chapter 13 can affect the foreclosure process.

§362. AUTOMATIC STAY

A filing under either Chapter 13 or Chapter 7 both initiate the automatic stay provisions of Section 362 of the Bankruptcy Code. Section 362 states:

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

* * *

(b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the securities Investor Protection Act of 1970, does not operate as a stay

Under subsection (a) of this section, of the commencement of any action by the Secretary of Housing and Urban Development to foreclose a mortgage or deed of trust in any case in which the mortgage or deed of trust held by the Secretary is insured or was formerly insured under the National Housing Act and covers property, or combinations of property, consisting of five or more living units;

* * *

(c) Except as provided in subsections (d), (e), and (f) of this section

(1) the stay of an act against property of the estate under subsection (a) of this section continues until such property is no longer property of the estate; and

(2) the stay of any other act under subsection (a) of this section continues until the earliest of

(A) the time the case is closed;

(B) the time the case is dismissed; or

(C) if the case is a case under chapter 7 of this title concerning an individual or a case under chapter 9, 11, 12, or 13 of this title, the time a discharge is granted or denied.

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest;

(2) with respect to a stay of an act against property under subsection (a) of this section, if

(A) the debtor does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization; or

(3) with respect to a stay of an act against single asset real estate under subsection (a), by a creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90-day period).

Simply stated, this section prevents the creditor from pursuing the debtor or its collateral unless the court grants relief. It also makes any actions taken in violation of the stay void. Actions in violation of the stay are void even though the creditor did not have any actual knowledge of the bankruptcy filing. A court normally will not award sanctions against the creditor for a violation of the stay where the creditor has no actual knowledge. It is the willful violations that are given the notoriety and sanctions.

Good practice dictates that due diligence be exercised when a file is received from a client. It should be "scrubbed", that is, reviewed thoroughly to see that all documentation is in order, that the notes and mortgages are properly executed, that the mortgages have been recorded and all comments from the client should be thoroughly reviewed to check out addresses plus any possible notice regarding a pending bankruptcy action.

One method of checking to see if there has been any type of bankruptcy filing is to use the Pacer system. You can access this site after setting up an account by going to www.pacer.uspci.uscourts.gov. We have noticed that it is not always reliable when checking under

the name search so we check not only the name, but also the social security numbers of all the borrowers that have executed the note. We also check local web sites for the bankruptcy courts when possible. The web site for the Northern District of Illinois is located at www.ilnb.uscourts.gov. We have found that in many cases, our clients are not aware of the debtor's bankruptcy and our due diligence in investigating accounts have uncovered this information.

WEB SITES OF INTEREST

PACER for the Northern District of Illinois
www.ilnb.uscourts.gov

Trustee Locator
www.bestcase.com/trustees.13.htm

Thomas Vaughn
www.l3network.com

Marilyn Marshall
www.chicago13.com

Glenn Steams
www.lisle13.com

Bankruptcy Courts
www.legal.gsa.gov

Freedman, Anselmo, Lindberg & Rappe
www.fallaw.com

CHAPTER 7 FILINGS

A Chapter 7 filing is what we refer to as the "etch-a-sketch" filing. Think of the time when we were all children. You drew on it and when you became tired of it or made a mistake, you turned it over, shook it and all the marks were gone and you started over again. Chapter 7 is much the same. The debtors list all their debts, file a Chapter 7 bankruptcy petition, are granted a discharge and their personal liability on all obligations is extinguished. They have obtained a "fresh start". What remains after the filing are the lien interests of the creditors in the security, such as autos and real estate.

The creditors, post discharge, may choose to move forward to act upon their security only. During the period from the date of the filing until the order closing the estate is docketed, a creditor, under Section 362, is precluded from taking any action against the collateral. If the creditor chooses to do so, a motion has to be presented to the bankruptcy court requesting leave to modify or terminate the automatic stay as to that particular piece of collateral. The motion is routinely granted unless there appears to be some equity in the collateral asset. A debtor does not generally file a Chapter 7 action when there is equity in any type of asset, or in our instance, the real estate which is encumbered with a mortgage. The mortgage balance, or balances in the event that there is more than one mortgage, is usually equal to or greater than the value of the real estate.

The filing of a Chapter 7 does present a creditor with certain opportunities. We have established that generally there will be no equity in the collateral that is secured by your mortgage. The debtor is well aware that he or she will eventually lose the real estate through the foreclosure process after the discharge has been granted in the Chapter 7 proceeding. In many instances, the debtor has already abandoned the property. Therefore, it does present a creditor with the opportunity to pursue a possible Deed in Lieu of Foreclosure or Consent Judgment as a means of obtaining quick and efficient control of the real estate. This can be accomplished through either attorney discussions or creditor discussions with the creditor's attorney. In most cases, you will find the attorney is amenable to working with the creditor toward this end.

In the event that the creditor does not move to modify the automatic stay, the creditor needs to wait for the docketing of the order closing the estate. The case of NBD Highland Park Bank v. Wien, 251 Ill.App.3d 512 (2nd Dist. 1993) is illustrative. In this case, the debtors filed a Chapter 7 bankruptcy and after the order had been signed, but prior to the date of docketing, the property was sold at a Judicial Sale. Subsequent to the date of sale, the order granting relief from the automatic stay was docketed. The Appellate Court stated it is clear that bankruptcy rule 9021 provides that

judgment is effective when entered as provided under Rule 5003, which requires that the clerk enter each judgment and order on a docket. Hence, orders do not become final until they are docketed as judges could change the orders prior to the docketing. Therefore, it is quite clear that the docketing of the order is the date that it becomes effective, not the date that the court actually signs the orders.

As the Wien case illustrates, it is necessary to wait for the docket of the order, not the mere signing of the order. Various jurisdictions have back logs which may mean that the orders are not docketed in a timely manner. A creditor who has modified the stay, needs to be cognizant of this time line and understand that attorneys must comply with Section 362.

Our office policy is to notify the creditor upon learning that a Chapter 7 action has been filed and immediately ask the client for some direction as to what action our office should take. The question goes to whether or not the client wishes us to modify the stay or wait until the discharge and docketing order. If a foreclosure case is pending when the debtor files, the matter is held in abeyance. We must also review the action taken in the foreclosure to see if it is void as it might have taken place in contravention of the Section 362 automatic stay. Examples of actions that might be taken are summons being served after the date of filing, judgments having been entered after the date of filing, or a judicial sale taking place. All of these examples assume that the attorney had not received notice of the bankruptcy prior to taking these actions.

In either of these examples, the summons would have to be re-served, judgment would have to be re-entered, or the property would have to be re-sold. It becomes very important that the creditors transmit any bankruptcy information immediately to the attorney handling the matter.

The issues that the bankruptcy department faces is time and cost. There is a fee that is charged by the Clerk of the Court and you will incur attorney fees if you need to modify the stay. So what do you do?

If you are notified after the first meeting is held and a no asset report has been filed, then it might be best to wait until the discharge is granted rather than incurring costs. However, if you are notified early on in the proceedings, then from a time standpoint, it might be best to modify the stay.

Our office need certain information in order to process the motion to modify. That information is:

- Copy of note and mortgage
- Property address
- Principal balance
- Monthly payment amount
- Payment due date
- Date of last payment
- Pre-petition arrears
- Pre-petition fees and costs
- Post petition amount due

Once this information is received, our office promptly prepares and sets down the Motion to Modify.

CHAPTER 13 FILINGS

Filings under Chapter 13 are debtor repayment plans. In essence, the debtor proposes a plan to re-pay secured creditors first and then pay a portion of the amount due to unsecured creditors. It is very important to review the debtor's plan once it is filed to match up the amount shown on the plan as to the principal balance due and the arrearage figures. The debtor's plan will control unless the creditor takes affirmative action to modify the plan as presented by the debtor by attending the 341 meeting and objecting to the plan.

The provisions of Section 362 apply to Chapter 13 filings. The automatic stay provisions apply to co-debtors as well as to debtors. Therefore, if only one of the two parties on the note files the Chapter 13 matter, the automatic stay applies to that non-filing debtor. Therefore, the discussion of Section 362 in the Chapter 7 section above applies equally herein.

Once our office learns that a Chapter 13 action has been filed or is pending, we immediately cease action. We do not unilaterally take action in a Chapter 13 proceeding. We need to obtain a referral from our client to handle this matter. It is common for our client to have separate foreclosure and bankruptcy departments. The bankruptcy departments in many instances will file a Chapter 13 proof of claim and follow through on the payments with the trustee as well as any regular payments that would be made outside of the Chapter 13 plan by the debtor directly to the creditor. These departments do not wish to incur additional attorney fees as part of their budgetary process. It is necessary to check with your clients prior to proceeding in any type of Chapter 13 matter to make sure that this is something that is authorized.

In our office, we hold the file for a sixty day period to check the bankruptcy docketing status. We would like to know whether or not any other mortgagees might have modified the automatic stay which would then necessitate our client taking action. We also check to see if the first meeting has been held or whether the Chapter 13 confirmation has been confirmed. If the Chapter 13 proceeding is moving forward and our client has not contacted our office with a referral to handle this matter, we will cease further work and close the file.

Please remember that you may have a pending foreclosure action. In most jurisdictions you will be faced with a case management or status date set by the court. Instead of continuing to appear in court, we dismiss the foreclosure with leave to reinstate. If the Chapter 13 action is dismissed or we move to modify the stay, we may then bring a motion to reinstate the foreclosure and move

forward with the proceeding from the point at which it was dismissed. In the interim, we have dispensed with the need to attend further court appearances and incur further expenses.

Very few Chapter 13 debtors go through discharge. If one does, your secured client would have been paid the arrearage figures and kept current during the pendency of the plan. The unsecured creditors may have been paid a percentage of their debts and are deemed to be paid as if these debts had been discharged. The permanent restraining provisions of Section 362 apply as to those unsecured creditors.

How do you handle a Chapter 13 plan? As seen above, it depends on whether the plan is filed in the Northern District Eastern Division or in any one of the other jurisdictions.

We have attached a copy of the "Model Plan" which was effective October 1, 2001. We have also attached the instructions for the Model Plan. This plan was approved and instituted as the bankruptcy judges felt that would lead to uniformity in filing and ease of administration. It may, but what it has done, is dramatically changed the way you need to handle these matters.

In jurisdictions other than the Eastern Division, a creditor will file its proof of claim. This proof of claim controls over the debtor's plan as to the amounts due, both in terms of regular payments, but also as to the arrears amount. The Model Plan in the Eastern Division states that the debtor's plan is controlling. Therefore, if there are arrears of \$4,000.00 and the debtor listed only \$2,000.00, then upon payment of \$2,000.00 the loan will be considered current.

What does the creditor need to do? In jurisdictions other than the Eastern Division, technically the creditor need not appear. There may be timing issues as to the payment of arrears, but ultimately, they would be paid in accordance with a timely proof of claim. In the Eastern Division, it is incumbent upon the creditor to pull and look at the plan proposed by the debtor (easy to do online). If the numbers are correct, then no action needs to be taken. However, if the numbers are incorrect, then the creditor needs to object to the plan. In many instances, having an attorney appear at the first meeting and discussing matters with the debtor's attorney will cause the debtor's attorney to file an Amendment of Plan. If this doesn't work, then a formal objection needs to be filed prior to the hearing to confirm the plan.

The net effect of the Eastern District Plan is to cause more work for the creditor. It also, in many instances, will require an attorney being present at the First Meeting or Plan Confirmation which will increase your costs.

As you saw in the section on Chapter 7, we can modify the stay in the event the debtor defaults on the payments. The stay will not normally be modified until after confirmation. The information that we need to modify is:

- Copy of note and mortgage
- Property address
- Principal balance
- Monthly payment amount
- Payment due date
- Date of last payment
- Pre-petition arrears
- Pre-petition fees and costs
- Copy of filed Chapter 13 claim
- Copy of plan (if available)
- Post petition amount due
- If case is over 6 months old, we will need a list of all payments received since filing. Amounts and dates received and if possible, advise if they were debtor or trustee payments.