CONSUMER BANKRUPTCY

"I Surrender" Does Not Mean I Surrender — Mortgagee Can't Hold Statement of Intention Against Debtor in Foreclosure Case

By Craig D. Robins

In my November 2017 column, "'I Surrender!' What Does That Mean?," I discussed the situation where a Chapter 7 consumer debtor declares in the "Statement of Intention" schedule to the petition, his or her intention to surrender their home, and what that declaration actually means.

At the time, many debtors later discovered to their dismay that declaring an intention to surrender their home precluded their ability to defend a state court foreclosure case. This was because foreclosing mortgagees would argue that the doctrines of waiver and judicial estoppel bar a debtor from taking a later, supposedly contrary position, even if that is many years after the bankruptcy case is over.

When I wrote my earlier article, courts around the country were split as to whether a debtor's declared intention to surrender property in a bankruptcy proceeding could prevent the debtor from later defending a foreclosure proceeding, and there was no authoritative case law in our jurisdiction.

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However, during the midst of our coronavirus pandemic, the United States District Court for the Eastern District of New York addressed this issue and held in favor of the debtor, essentially saying that a debtor who indicates a surrender of property in the bankruptcy petition should not be prevented from defending a state court foreclosure proceeding and contesting the validity of the mortgagee's right to foreclose. *Federal National Mortgage Association ("Fannie Mae") v. Alarcon*, 19-cv-5079, 2020 WL 3104034 (E.D.N.Y, June 11, 2020)

In *Alarcon*, which started out as a routine consumer Chapter 7 filing in 2014, the debtor owned a mortgaged house in Queens. As part of the filing, the debtor completed the "Statement of Intention" form which, pursuant to Bankruptcy Code § 521(a)(2), required the debtor to declare his intent with regard to his secured property. He checked the box to indicate his intent to "surrender" his home. About four months after filing, the court routinely granted a discharge and closed the case.

Three years later, in 2018, Fannie Mae commenced a foreclosure action in Queens County Supreme Court. The debtor filed an answer with counterclaims asserting the statute of limitations. According to the debtor, the statute of limitations expired in 2015, making the mortgage unenforceable.

Fannie Mae believed they had an opportunity to prevent the debtor from pursuing that defense, so in August 2019, it moved the Bankruptcy Court for an order to reopen the Chapter 7 case, arguing that because the debtor indicated he intended to surrender the house in his Statement of Intention, he had no right to contest the foreclosure action. Fannie Mae asked the Bankruptcy Court to "enforce the surrender" by ordering the debtor to stop contesting the foreclosure.

Judge Nancy Hershey Lord, sitting in the Brooklyn Bankruptcy Court, heard oral argument at which the debtor did not appear. Fannie Mae argued that when the debtor chose to surrender the property, he chose to give up all rights to the property, and by raising the statute of limitations, the debtor was "trying to get the property for nothing."

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Fannie Mae asked the court to follow *In re Failla*, 838 F.3d 1173 (2016), a widely-cited Eleventh Circuit decision which held that "surrender" requires debtors to drop their opposition to foreclosure actions. The Failla decision further held that bankruptcy courts have the power to compel debtors not to oppose a foreclosure action in state court.

However, Judge Lord denied Fannie Mae's motion. Opining in a colorful manner, the judge stated that a debtor's marking his intent to "surrender" property in his bankruptcy petition "in the practical world doesn't really mean a whole lot."

Judge Lord explicitly disagreed with *Failla's* conclusion – that a debtor's checking the "surrender" box means that he gives up all rights to the property – expressing that "in Brooklyn that's not the way this works." The Bankruptcy Court ultimately saw no basis on which to order the debtor not to contest the foreclosure action. This led Fannie Mae to appeal to the District Court.

The debtor did not appear in the appeal either, yet the District Court affirmed the Bankruptcy Court's decision and Fannie Mae lost. District Court Judge Allyne R. Ross clearly rejected *Failla*, stating, "In sum, the bankruptcy court declined to save Fannie Mae from its own failure to abide by the statute of limitations in state court by reopening a case to adopt an out-of-circuit rule that would afford significantly more weight to a checkmark on a several-year-old form than was required in this circuit." The District Court continued, "Absent any binding Second Circuit precedent on the issue, such a decision was well within the bankruptcy court's discretion."

The District Court adopted Judge Lord's position that the Bankruptcy Court only accords limited significance to the "surrender" checkmark box. Fannie Mae tried to argue that if a debtor is represented by counsel who prepares the petition, the debtor certainly must understand the implications of checking the "surrender" box. However, Judge Ross held that even when a debtor is fully informed, the "surrender" checkmark has limited significance in the Eastern District of New York and cannot save Fannie Mae from a state-court statute of limitations. Thus, Judge Ross concluded that the Bankruptcy Court acted within its discretion in determining that cause did not exist to reopen the bankruptcy case, meaning that it could not award relief to Fannie Mae.

Practical Tips. Even with this new decision, debtors should avoid checking the "surrender" box on the Statement of Intention. Why ask for trouble? Although the Bankruptcy Court in Alarcon refused to reopen the case to accord relief to the mortgagee, Judge Lord noted that the mortgagee could have still raised this issue in state court.

In addition, debtors should consider listing mortgage debts as disputed and include, as an asset, a claim against the mortgagee. Although this would probably result in the trustee asking additional questions, doing so would mean that the debtor would have a claim or dispute against the mortgagee that could survive the bankruptcy case and be litigated as part of the foreclosure proceeding.

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