Chap 13 Debtor Got More than She Bargained For

By Craig D. Robins

For quite some time, consumer bankruptcy practitioners in our district have suggested to some clients with mortgage arrears that they consider seeking Chapter 13 relief combined with an application for loss mitigation. Loss mitigation is a voluntary program in which the debtor seeks to obtain a mortgage modification from the lender, with court supervision of the process.

Two of our three judges in the Central Islip Bankruptcy Court participate in this program – Judges Robert E. Grossman and Louis A. Scarcella. Chief Bankruptcy Judge Alan S. Trust has chosen not to participate, but generally permits debtors to engage in the process for a reasonable period of time without court supervision, during which time confirmation hearings are adjourned.

When a debtor seeks loss mitigation, the Court and the trustees usually require the debtor to make good faith payments into the plan for the anticipated amount of the monthly mortgage payments. Counsel would tell their clients whose plans were dependent upon obtaining a modification that in a worst case scenario, being that the mortgagee declines to grant a modification, the debtor's case will be dismissed, but the debtor will get all payments they made into the plan refunded, less a small amount for statutory trustee's commissions.

However, a recent decision by Chief Judge Trust may have thrown a monkey wrench into such advice. In re Sandra Celasco-Rodriguez (Bankr. E.D.N.Y. Case No. 19-73623, January 14, 2021.). In that case, the debtor filed a plan which called for post-confirmation payments to be made to the mortgagee based on a loan modification the debtor hoped to obtain. The plan provided that the estimated monthly payment shall be paid directly to the trustee while loss mitigation is pending and until such time as the debtor has commenced a payment under a trial loan modification. The debtor made the plan payments as required while she sought a modification.

A year later, after the lender denied the debtor a modification which the debtor unsuccessfully appealed, the trustee brought a motion to dismiss. The debtor, hoping to stay in the comfort of the bankruptcy proceeding, filed opposition to the motion indicating that the debtor was going to apply for a modification a second time. However, before the Court could entertain the motion to dismiss, the mortgagee filed a motion for pre-confirmation adequate protection. This motion was filed about 17 months after the petition date.

Debtor's counsel, Lindenhurst bankruptcy practitioner Richard F. Artura, quickly withdrew his opposition to the trustee's motion to dismiss, hoping the Court would grant the trustee's motion without entertaining the mortgagee's motion for adequate protection payments. However, the debtor was not so fortunate.

Adequate protection is a concept mostly seen in Chapter 11 cases. It involves requiring a debtor to provide assurance to a secured creditor that their collateral will be protected in the bankruptcy from a loss of value. To accomplish this, the debtor usually make monthly "adequate protection payments" to the secured creditor.

The mortgagee, Select Portfolio Servicing, sought an adequate protection payment of $34,000 representing the all of the proposed mortgage payments called for under the plan up through the date of the motion. At the time, the trustee was holding about $36,000. The debtor opposed the motion, but argued that if adequate protection payments should be made, they should only be made for the period after the motion was filed.

The debtor also made an interesting argument, asserting that granting retroactive adequate protection violates the United States Supreme Court's recent admonition in Roman Catholic Archdiocese v. Acevedo, 140 S. Ct. 696, concerning nunc pro tunc orders. Last year, Judge Grossman issued a decision case in In re Benitez (No. 8-19-70230-REG, 2020 WL 1272258) in which he held that the nunc pro tunc orders in bankruptcy cases were often inappropriate. That case had to do with a request for nunc pro tunc approval of estate professionals.

Judge Trust quickly dispatched that argument, stating that the Court views a request for retroactive adequate protection payments differently than a nunc pro tunc order. "SPS is not asking for an order to be entered now to reflect relief as if granted previously. SPS is seeking relief that was not sought sooner in the case."

As he typically does, Judge Trust first turned to the appropriate sections of the Bankruptcy Code for guidance, discussing sections 361, 362 and 363. The Judge also noted that during an extensive post-petition period, the mortgagee not only received no payments, but it advanced over $9,500 in real estate taxes and insurance premiums.

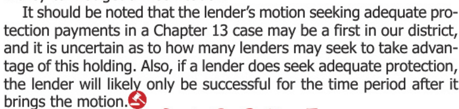
Judge Trust determined that SPS was entitled to receive adequate protection payments, something that came as quite a shock to the debtor. However, the Judge only held that SPS should receive adequate protection payments from the date it filed its motion, plus reimbursements for the real estate taxes and insurance.

In analyzing case law, Judge Trust stated that allowing adequate protection to a lender is appropriate once a lender has filed a motion seeking such relief, and granting retroactive relief to a time prior thereto is not appropriate absent exceptional circumstances.

The judge even commented that the lender chose to wait a long period to file its motion. Lenders should have a reasonable expectation that upon request, out of pocket post-petition payments and expenditures made for real estate tax obligations and insurance will be reimbursed, stated the Judge. Accordingly, the Court dismissed the case and ordered the trustee to disburse to SPS $7,000 representing three months post-motion payments and $9,500 for real estate taxes and insurance, for a total of $16,500. Thus, although the lender's motion for adequate protection came out of left field, the debtor was successful in persuading the Court that adequate protection should be limited.

Mr. Artura, commenting on the case for this article, said that based on the decision, consumer bankruptcy counsel should notify clients when there is a possibility that they might have to pay adequate protection payments, and that they should be cautioned that there is no guarantee of getting back payments made to the trustee if they cannot get a modification.

It should be noted that the lender's motion seeking adequate protection payments in a Chapter 13 case may be a first in our district, and it is uncertain as to how many lenders may seek to take advantage of this holding. Also, if a lender does seek adequate protection, the lender will likely only be successful for the time period after it brings the motion.



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