Lowndes

Discharge of Condominium and Homeowners' Assessments in Bankruptcy

Feb 05, 2018

By: Jason W. Johnson and David E. Peterson

The Florida Bar Journal

View Link

Since the early 1990s, the federal courts have struggled with whether, and to what degree, a debtor in bankruptcy who receives a discharge is free from liability for post-petition condominium and homeowners' association assessments. The issue is important to condominium associations and homeowner's associations, as well as debtors in bankruptcy. Because the association's assessment lien is often junior to mortgages, foreclosure of the lien may be useless. Therefore, an association might bring a lawsuit seeking a personal money judgment against the owner, hoping the owner's other assets will satisfy the assessment. The debtor's ability to discharge the assessments is, therefore, of paramount importance. While an owner who has been stripped of assets in bankruptcy is not an ideal defendant, associations have sometimes sought to hold discharged debtors liable for delinquent assessments. The question of whether post-petition assessments are discharged takes on added importance because a "discharge injunction" precludes enforcement of a discharged debt and is enforceable by sanctions.[1]

As a result, a few reported bankruptcy cases deal with the discharged owner's liability for assessments. Unfortunately, those cases have not been consistent. Despite two congressional

amendments to the Bankruptcy CodJason W. Johnson
- David E. Petersone that were intended to clarify the law, the dispute has not been fully resolved.

The Discharge
One of the principal purposes of the Bankruptcy Code is to provide a means by which an honest but unfortunate debtor may obtain a "fresh start," allowing the debtor to be rid of many debts that cannot be repaid. The discharge is subject to certain exceptions enumerated in §523 of the Bankruptcy Code, many of which relate to whether the debtor is indeed honest and unfortunate, or rather a scoundrel unworthy of a fresh start. Blackletter bankruptcy law holds that the debtor is discharged of liability only for pre-petition debts, and not for post-petition debts.[2] Statutorily, that line is drawn most clearly in Ch. 7 (involving a liquidation of the debtor's nonexempt assets in exchange for receiving an immediate discharge),[3] and less so in Chs. 11, 12, and 13 (where the trade-off for receiving the discharge is that the debtor must pay at least a portion of the debts over time pursuant to an approved plan).[4] Mostly, however, the ambiguity in the case of condominium and homeowners' assessments concerns whether the assessments arise pre-petition or post-petition. Unfortunately, the courts have had divergent views.

Congress Takes on the Caselaw
In In re Rosteck, 899 F.2d 694 (7th Cir. 1990), the Seventh Circuit held that the assessment arose under a contract the debtor entered into prior to the bankruptcy and so, even post-petition assessments were discharged.[5] After noting that the terms "debt" and "claim" were broadly defined by the Bankruptcy Code to include all legal obligations of the debtor, no matter how remote or contingent, the Seventh Circuit concluded that the assessments that came due after the bankruptcy filing were actually a pre-petition debt:

"Under those broad definitions of claim and debt, the Rostecks had a debt for future condominium assessments when they filed their bankruptcy petition. It is true that the Rostecks did not actually owe money to Old Willow….But the condominium declaration is a contract…and by entering that contract the Rostecks agreed to pay Old Willow any assessments it might levy. Whether and how much the Rostecks would have to pay in the future were uncertain, depending upon, among other things, whether the Rostecks continued to own the condominium and whether Old Willow actually levied assessments. But, as we have seen, contingent, unmatured, unliquidated, and unfixed debts are still debts."[6]

Therefore, the court held that the post-petition assessments were actually pre-petition debts subject to discharge under Bankruptcy Code §727(b).

However, Rosteck was not the last word. In River Place E. Hous. Corp. v. Rosenfeld (In re Rosenfeld), 23 F.3d 833 (4th Cir. 1994), the Fourth Circuit rejected the Rosteck analysis:

Jason W. Johnson
- David E. PetersonJason W. Johnson
- David E. Peterson"The [d]eclaration expressly states that it is a covenant running with the land and binds and inures to the benefit of all present and future owners….Rosenfeld never signed the [d]eclaration itself, but his proprietary lease expressly provides that it is subject to the [d]eclaration.

"Under the [d]eclaration, the obligation to pay assessments is a function of owning the land with which the covenant runs. Thus, Rosenfeld's obligation to pay the assessments arose from his continued post-petition ownership of the property and not from a pre-petition contractual obligation….River Place's right to payment for post-petition assessments did not arise pre-petition and was not extinguished by Rosenfeld's bankruptcy discharge."[7]

The Fourth Circuit was not alone in its dissatisfaction with Rosteck. In 1994, as a result of Rosteck, Congress enacted 11 U.S.C. §523(a)(16). The purpose of §523(a)(16) was to roll back Rosteck by excepting certain post-petition assessments from discharge. In 2005, Congress broadened the exception to make clear that assessments by homeowners' associations were included in the exception and to address other gaps that courts had identified in the language. The revised language provides in pertinent part as follows:

"(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

***

"(16) for a fee or assessment that becomes due and payable after the order for relief to a membership association with respect to the debtor's interest in a unit that has condominium ownership, in a share of a cooperative corporation, or a lot in a homeowners association, for as long as the debtor or the trustee has a legal, equitable, or possessory ownership interest in such unit, such corporation, or such lot, but nothing in this paragraph shall except from discharge the debt of a debtor for a membership association fee or assessment for a period arising before entry of the order for relief in a pending or subsequent bankruptcy case…."[8]

Even so, gaps remain. Although §523(a)(16) currently extends to a "homeowners association," it is not clear how assessments by nonresidentialproperty owner associations would be treated. Also, §523(a)(16) applies only to individuals, so it is not clear how assessments against nonindividual debtors in Ch. 11 would be treated.[9] However, as the law now stands, the Rosteck andRosenfeld decisions have been supplanted by §523(a)(16), at least for individual debtors in Chs. 7, 11, and 12.[10] In those instances, it does not matter whether the post-petition assessments arise post-petition or under a pre-petition contract because §523(a)(16) makes no distinction so long as the assessment comes "due or payable" after the order for relief.[11] In Ch. 13, however, it may be a different story. Because Congress enacted §523(a)(16) to address the split of authority growing out of Rosteck, one might think that one should fall back on Rosteck and Rosenfeld to resolve disputes where §523(a)(16) does not apply. However, not all courts have agreed, and Ch. 13 has been their battleground.

Discharge of Post-Petition Assessments in Ch. 13

Chapter 13 is a provision of the Bankruptcy Code that allows an individual debtor to remain in possession of his or her property, continue to generate income for the estate, and to propose a plan that alters the payment terms of the debtor's debts in an effort to work out his or her financial difficulties. Upon completion of the payments under the plan, the debtor is entitled to a discharge.[12]

Congress enacted Ch. 13 in the hope that it would result in greater payment to creditors than often results from a forced sale of the debtor's assets in Ch. 7. In order to encourage debtors to opt for Ch. 13 instead of Ch. 7, Congress offered a number of advantages to debtors under Ch. 13, one of which was an expanded "superdischarge." Certain obligations that were excepted from the discharge under Ch. 7 might be dischargeable under Ch. 13.[13]

Pursuant to §727(b) of the Bankruptcy Code, all pre-petition debts are discharged in Ch. 7 unless one of the exceptions to discharge listed in §523(a) applies. The exception for post-petition assessments is among those listed in §523(a). The discharge exceptions listed in §523(a) are also applicable in Ch. 13 to some degree, as is evident from the prefatory language of §523(a), which references §1328(b), a Ch. 13 discharge provision that applies only if the debtor fails to complete the plan payments. However, §523(a) makes no reference to §1328(a), which applies if the debtor does complete the plan payments. Rather, §1328(a) itself selectively incorporates a number

of §523(a) exceptions to the discharge, but omits a handful of other §523(a) exceptions, which are considered part of the debtor's "superdischarge," because while those debts are excepted from the Ch. 7 discharge, they are not excepted in Ch. 13. Among those omitted is §523(a)(16). Relying on the plain language of the statute, courts have held that §523(a)(16) does not apply when the debtor seeks a discharge under §1328(a), and some courts have concluded that the debtor is discharged of both pre-petition and post-petition assessments, as part of the debtor's superdischarge.[14]

Although pursuant to the logic of Rosenfeld, the assessments are not pre-petition debts and, therefore, are not discharged in any event, some courts have said that by enacting §523(a)(16), Congress effectively ratified Rosteck(and rejected Rosenfeld) because 1) the legislative history specifically stated that the debt would be dischargeable in the absence of an exception, citingRosteck,[15] and 2) no exception would be needed if the debt were not otherwise dischargeable.[16]

While the legislative history is in some respects helpful to courts followingRosteck, in others it is not. One of the sponsors of §523(a)(16), Sen. Thurmond (R–South Carolina), referred to "the current ambiguity in the Bankruptcy Code" and stated: "It is necessary to correct a line of cases in which courts have held that future payments by the debtor to a community association are discharged in bankruptcy."[17] Thus, Congress may not have agreed with Rosteck, but only acknowledged "ambiguity." The purpose was not to ratify Rosteck, but to overturn it.[18]

Further, it does not follow that by enacting §523(a)(16), Congress conceded that the debt was dischargeable. By enacting a limited exception to the other discharge statutes, Congress was not necessarily implying anything about §1328(a) or the applicability of Rosteck and Rosenfeld.
In Heffner v. Elmore,Throop & Young, P.C., 2012 WL 8466127 (D. Md. June 12, 2012), the court summarized the debtor's argument as follows:

"Heffner argues that by adding this provision, Congress implicitly adopted the Seventh Circuit's reasoning in Rosteck (that such assessments are contractual, pre-petition obligations) and rejected the reasoning set forth by the Fourth Circuit in Rosenfeld (that such assessments are post-petition obligations that run with the land). By specifically excluding these assessments from the discharge, goes the argument, Congress acknowledged that without this statutory exception, the assessments would otherwise be discharged."[19]

However, the Heffner court stated that because "[§§]523(a)(16) and 1328(a) are 'mutually inapplicable based upon a plain language of the Bankruptcy Code,'" the debtor attached "undue significance" to §523(a)(16) in his interpretation of §1328(a). The court further said, "The [c]ourt declines to infer that by not expressly connecting these unrelated sections, Congress intended to broaden the §1328(a) discharge to include assessments that are excluded from other types of bankruptcy discharges."[20] The court also said, the "argument that Rosenfeld is no longer good law is further undermined by the numerous courts that have continued to follow Rosenfeld even after implementation of the 1994 and 2005 amendments…."[21]

Further, by enacting §523(a)(16), Congress at most recognized only that someassessments might otherwise be dischargeable, depending on state law. TheRosteck courts say that the question of whether the claim arose pre-petition or post-petition is a federal question,[22] no doubt because the terms "claim" and "debt" are defined by the Bankruptcy Code. However, Rosteck itself cited Illinois law in concluding that assessments coming due post-petition arise under a pre-petition contract. Rosenfeld relied upon Virginia law in holding that those assessments arise post-petition.[23] Thus, it seems that the result is governed at least in part by state law.[24] By enacting

§523(a)(16), Congress was not necessarily acknowledging that post-petition assessments are always dischargeable absent the exception. It may have acknowledged that in certain states they are dischargeable absent the exception.

In Foster v. Double R Ranch Ass'n (In re Foster), 435 B.R. 650 (9th Cir. BAP 2010), the court considered post-petition assessments in the context of a §1328(a) discharge.[25] The court said that Congress enacted §523(a)(16) to resolve the conflict between Rosteck and Rosenfeld, but because §523(a)(16) does not apply to §1328(a), "we revisit the Rosteck and Rosenfeld era."[26] The court further said that "state law governs the substance of claims."[27] The court held that under Washington law, the obligation arose post-petition under a covenant that runs with the land, and so long as the debtor owned the land, the debtor was liable for post-petition assessments. However, the case dealt with a situation in which the debtor remained in possession of the property. The court stated: "[W]e doubt the omission of §1328(a) in §523(a)(16) or vice versa evinces a legislative intent to discharge post-petition HOA dues under §1328(a) when the debtor uses the cure and maintenance provisions under [Ch.] 13 to stay in his or her property."[28] That leaves the possibility that the court may have permitted discharge if the debtor had not remained in possession, although that would seem to depart from the court's reasoning that the assessments were post-petition debts.[29] More likely, the court was simply using the strong facts before it to illustrate its point that Congress surely did not intend to discharge post-petition assessments.[30]

In Otter Creek Homeowners' Ass'n v. Davenport (In re Davenport), 534 B.R. 1, 3-4 (Bankr. E.D. Ark. 2015), the court noted that the discharge in §1328(a) is limited by its own terms so that it might not cover post-petition assessments in any event. Section 1328(a) states that the debtor is discharged of "all debts provided for by the plan or disallowed under section 502 of this title…." A debt is "provided for" when the plan contains some provision describing the treatment of that debt.[31] Absent such a provision, the debt is not discharged.[32]

At first glance, this language seems to benefit the debtor because it implies that the post-petition assessments could be discharged if the plan so provides.[33]Also, unless the association obtained an administrative priority for its post-petition assessments, the debtor might discharge the debt in the plan for less than what is owed.[34]

However, Davenport noted §1305 expressly provides certain instances in which a post-petition claim is allowed under Ch. 13, and held in effect that §1305 lists the only instances in which post-petition claims can be restructured in Ch. 13.[35] The court also said that §1305 does not apply unless the creditor itself seeks allowance of its post-petition claim,[36] but observed that §1305 does not fully resolve the issue because the question remains whether the assessments are post-petition or pre-petition debts. As a result, the statute points inevitably back to Rosteck and Rosenfeld to make that call.

Rosteck relied foremost on the definition of "claim" in the Bankruptcy Code. In reality, the definition of "claim" does not distinguish between post-petition and pre-petition debts, nor does the definition of "debt."[37] The definition of "creditor" does distinguish,[38] but that, if anything, works to the benefit of Rosenfeld's argument because post-petition claimants are not "creditors" bound by the plan under §1327(a).[39] There is no doubt that a post-petition assessment is a "claim." The question is whether it is a pre-petition or a post-petition claim. The reason the Rosteck courts focus on the definition of "claim" is that they believe the definition provides a clue as to when a particular claim arises.[40] Because the definition includes contingent and unliquidated rights to payment, the courts found that even before the bankruptcy was filed, the post-petition assessment was a

contingent, unliquidated "claim."

Courts following Rosenfeld sometimes argue that a condominium declaration is not usually an executory contract.[41] It creates a servitude, which is a property interest. The debtor need not be, and usually is not, a signatory to the declaration. Indeed, the condominium developer may be the only party to the declaration, not as a contracting party, but as a grantor or declarant. The association may not even exist at that time. The unit owners become bound to the declaration not by contract, but rather by operation of the law of property.[42]As in the case of real estate taxes, the obligation to pay assessments arises when and if they are imposed on the owner, not at the time the debtor acquired the property.[43] Thus, the Rosteck argument that post-petition assessments arise pursuant to a pre-petition contract is not quite accurate, at least in most states. In fact, in some states, including Florida, the right to impose assessments is, in large part, statutory.[44]

The challenge for the Rosenfeld courts is to explain why §1328(a) is not listed in §523(a)(16) and vice versa.[45] One possible explanation is that there may be some states where Rosteck applies as a matter of state law. In addition,Davenport suggests that if the association were to file a claim under §1305 for post-petition assessments, those could potentially be discharged under §1328(a). Congress may have intended to expand the superdischarge to those situations without otherwise altering the discharge in those states whereRosenfeld applies. A similar argument might be that §523(a)(16) should be regarded as a safe harbor that protects post-petition assessments from discharge, but which is limited to certain circumstances and does not alter the rules of dischargeability in those instances where it does not apply.

It seems that the Rosteck courts are focused on finding some method by which the debtor may absolve himself of future assessments for a property that he does not want. In In re Rosa, 495 B.R. 522, 523 (Bankr. D. Haw. 2013), the court stated: "The debtor has wisely decided to get rid of the property. But this is easier said than done. The mortgagor ordinarily cannot compel the mortgagee to foreclose, and the mortgagor cannot convey the property to the mortgagee or anyone else unless the mortgagee/grantee accepts the conveyance."

As a result, some courts have actively sought to hold the debt dischargeable despite Rosenfeld. In In re Colon, 465 B.R. 657 (Bankr. D. Utah 2011), for example, the court sidestepped the issue of whether the obligation ran with the land, and despite noting that the debtors retained title to the property, stated, "the [d]ebtors have no consequential interest in the [p]roperty that measures up to rights to exercise ownership interests and control."[46] Of course, the question of whether the debtors' ownership was sufficient to trigger liability was a matter of state law, not bankruptcy law. One might even suggest that it would be more appropriate for a state court judge to make that determination rather than a bankruptcy court judge. The bankruptcy courts seem motivated to resolve these issues themselves, however, where the debtor's discharge is involved.

Conclusion

The courts following Rosteck and holding that post-petition assessments are included in the Ch. 13 superdischarge give more significance to every aspect of the text of §523(a)(16) and §1328(a) than do courts that hold those assessments are discharged under Rosenfeld. One can sympathize with the unfortunate debtor in Rosa. However, the analysis those courts employ is more complex than the Rosenfeld analysis and creates a number of new issues. TheRosteck courts would presumably hold that post-petition assessments against a nonindividual debtor under Ch. 11 or by nonresidential property owner's associations remain dischargeable notwithstanding §523(a)(16). Further, not every debtor desires to abandon the property as did the debtor in Rosa. TheRosteck courts might make exception for the situation in which the debtor retains the property, but it is a struggle to explain why there should be such an exception given their statutory logic, and in particular, why a post-petition decision by the debtor should impact the discharge of what they consider to be a pre-petition debt. A debtor retaining the condominium could potentially be

compelled to pay the post-petition assessments under an executory contract theory,[47] but if courts treat these arrangements as executory contracts, then the debtor would presumably be required to pay pre-petition arrearages as well, pursuant to 11 U.S.C. §365(b).

A simpler approach would be to regard §523(a)(16) as a safe harbor that does not alter the underlying rules of dischargeability in those situations in which it does not apply. However, courts would still be confronted with whether Rosteckor Rosenfeld governs when the safe harbor does not apply, and there is no assurance the result would favor the unfortunate debtor in Rosa while protecting the association in other instances. Perhaps a compromise would be to hold that while Congress did not intend to codify Rosteck with the enactment of §523(a)(16), it nevertheless did intend to include post-petition assessments in the debtor's Ch. 13 superdischarge in those states where Rosteck applies as a matter of state law. That would place the burden on the association to object if the post-petition assessments are not properly treated in the Ch. 13 plan in those states.

The disagreement between Rosteck and Rosenfeld has not been resolved. Despite congressional action, the disagreement continues to remain important in Ch. 13, as well as in cases involving nonresidential property owners' associations and nonindividual debtors. The courts will inevitably find themselves dealing with these issues until either Congress or the Supreme Court definitively resolves the matter.