Bankruptcy and Community Associations: What an Association Can and Cannot Do When An Owner Files Bankruptcy

By Gabriella R. Comstock

INTRODUCTION

Generally, condominium, townhome, or homeowner associations are not for profit corporations. Each owner within an association is obligated to pay either monthly or yearly assessments. The assessments are the life blood of the association, as the collection of assessments ensures that the association can perform its primary function, to maintain the common area. Undoubtedly, unit owners default on the payment of their assessments. It is essential for associations to take all necessary steps to collect the assessments from all unit owners. However, it is difficult, if not nearly impossible, to do this when an owner files for bankruptcy.

An individual owner can file bankruptcy either under Chapter 7 or 13 of the Bankruptcy Code. Under Chapter 7, the debtor is asserting that he has no assets; he is asking the Court to discharge him of his liabilities. If the Trustee finds that the debtor does not have any assets he will file a no asset report and the debtor will usually receive a discharge from the Bankruptcy Court.

In a Chapter 13, a debtor submits a plan to the Bankruptcy Court. Through his plan he attempts to reorganize. The debtor's goal is to pay his creditors, but over a period of time. Since an owner owes the Association for unpaid assessments, the Association is a secured creditor who should be included in the owner's bankruptcy plan.

Once an owner files bankruptcy, the Association, like all creditors, is prohibited from taking any steps to recover the debt. This is regardless if the owner files for protection under Chapter 7 or 13, an automatic stay goes into effect. Pursuant to 11 U.S.C.A. §362, the automatic stay prevents any and all creditors of the debtor from taking any action ". . . to collect, assess, or recover a claim against the debtor that arose before the commencement of the case. . ."[1]

Therefore, what can an association do when a unit owner, who is in default on the payment of assessments, files for bankruptcy? The U.S. Bankruptcy Code is voluminous and it can be confusing. The purpose of this article is to provide basic guidelines as to what can and cannot be done when an owner is also a debtor in a bankruptcy action.

WHAT CAN AN ASSOCIATION DO WHEN AN OWNER FILES BANKRUPTCY UNDER CHAPTER 7?

As already stated, a debtor who files for bankruptcy protection under Chapter 7 is asserting that he does not have any assets.[2] In a Chapter 7, there is only so much an Association can do to protect its interest. Typically, it does not file a Proof of Claim. Since the debtor is seeking a discharge, it does not submit a plan to the Bankruptcy Court which outlines how the debtor attempts to repay his creditors. It is important to note, that a discharge in bankruptcy only discharges the debtor of any personal liability to the creditor. That is, the creditor's lien against the debtor's property may remain.[3] The creditor may take steps to collect on its lien against the property. Yet, under no circumstances can it seek to collect against the debtor personally for a debt that the Bankruptcy Court has declared is discharged.

WHEN THE DEBTOR IN A CHAPTER 13 DOES NOT PAY

When a bankruptcy owner is involved in a Chapter 13 bankruptcy plan, the Association wants to be sure it files a Proof of Claim. Once the Association files its Proof of Claim, the debtor is supposed to continue to pay his current assessments to the association. In addition, once the Proof of Claim has been processed by the Bankruptcy Court and the Trustee, the association should receive payments from the Trustee's office, for the pre-petition assessments, through the debtor's bankruptcy plan. In addition the association should continue to receive payments from the debtor for his current post bankruptcy petition assessments. What happens when the owner stops paying his current assessments and/or the association stops receiving payments from the Trustee? After all, an automatic stay is in effect.

First, the association, through its attorney can send a letter to the debtor's bankruptcy attorney inquiring as to when or if payments will be made. In some cases a simple letter to the bankruptcy attorney will result in the debtor paying the amount due and owing for post petition assessments. In addition, the attorney may provide additional information regarding the progress of the bankruptcy.

If the association is not receiving payments from the Trustee for pre-petition assessments it may be helpful to check the status of the bankruptcy case. In the Northern District of Illinois, Eastern Division, online case information is available through the governments "PACER" system at http://racer.ilnb.uscourts.gov/perl/bkplog.html. When checking the status of the case, the association can review the docketing information to check pending actions like motions to dismiss, confirmation or conversion hearings. It is helpful for the association to have this information. It is not uncommon that if a debtor is not making payments to the Trustee so that the Trustee has the necessary funds to pay pre-petition debts, the Trustee will file its own Motion to Dismiss. If the Motion to Dismiss is granted, the association can proceed against the debtor as the automatic stay will no longer be in effect.

Second, the association can petition the bankruptcy court and request that the automatic stay be lifted. This is typically done by filing a Motion to

Modify the Automatic Stay. The basis for filing such a motion, includes, bad faith, non-payment, and damage to property as outlined in 11 U.S.C. §362(18)(c)(2)(C). An owner's failure to make regular assessment payments is cause to lift the automatic stay. While a Motion to Modify the Automatic Stay is a more costly option for an association to pursue, it is a powerful tool to either get the debtor to pay or to obtain relief from the automatic stay. Oftentimes, unit owner debtors will bring their post petition assessment accounts current in order to avoid modification of the stay by the Bankruptcy Court.

If a motion to modify the automatic stay is granted the creditor is free to pursue all legal remedies available to it, to collect the unpaid assessments, including the filing of an action pursuant to the Forcible Entry and Detainer Act.[4] Yet, what happens if the motion is denied or the Association does not have a basis to file a motion? What can the Association do to protect its interest? Can the Association even send the owner a statement of account? Can the Association continue to assess charges to the owner's account?

COMMUNICATIONS WITH THE DEBTOR

Typically, the Association's treasurer or property manager generates a monthly account statement, which outlines the charges posted to an owners account, *i.e.* assessments, late charges, special assessments and/or fines. But can an association send an account statement to an owner, who has filed for bankruptcy protection or is this communication a violation of the automatic stay? The answer is yes, the Association can simply notify a debtor of the balance on his account.

In Haymaker v. Green Tree Consumer Discount Store, the debtor, filed for bankruptcy under Chapter 7 and asserted that Green Tree Consumer Discount Store violated the automatic stay in that it sent the debtor monthly statements which stated that the debtor's account was in arrears, along with a flyer offering to refinance their debt.[5] In addition, the Haymaker debtor claimed Green Tree violated the automatic stay by contacting the debtors by telephone and inquiring if the debtors wanted to refinance the debt.[6] Haymaker held, after a hearing on the matter was conducted, that the debtors failed to prove that Green Tree violated the automatic stay.[7] The Court further stated that even if Green Tree did that which the debtors claimed, it was not a violation of the automatic stay for two reasons.[8]

First, "[r]equests by a creditor for payment of a debt are *not* in violation of §362(a)(6) without a showing of harassment or coercion by the creditor."[9] The Haymaker court also stated that the automatic stay is to prevent a creditor from making threats of immediate action to a debtor.[10] It is not intended to prevent all communications between a debtor and a creditor.[11] Second, the Haymaker Court held that since the discharge granted to the debtor, did not extinguish the creditor's lien against the property, it was proper for the creditor to contact the debtor to see if they wanted to refinance their debt under better terms than were currently in effect.[12]

Hence, according to Haymaker, if a creditor simply sends a debtor a monthly statement of account it is not a violation of the automatic stay. Thus, an association can communicate to the debtor the amount in arrears. Under no circumstances can it threaten to take legal action if the debtor fails to pay.

ASSESSING FEES TO THE DEBTOR'S ACCOUNT

Once a unit owner becomes delinquent, charges continue to accrue against the account. The debtor remains obligated to pay his current assessments. Most associations assess a late charge if assessments are not paid by a certain date. The bankruptcy code does not alleviate a debtor's obligation to pay these assessments and charges. In some cases, prior to an owner filing for bankruptcy protection, an association may have already initiated legal proceedings against an owner for unpaid assessments and/or violation of the association's restrictions. Inherently, the association would have incurred legal fees. Additionally, fines may have been assessed to the owner's account. Can the association include all of these amounts as part of its Proof of Claim? Can the association continue to assess charges to an owner's account after the owner has filed for bankruptcy? The answer to both questions is yes.

The Court in In re Karin-Marie Lund addressed the issue of what amounts can be included in a creditor's Proof of Claim.[13] The creditor in Lund was a condominium association, governed by a declaration, rules and regulations, and the Illinois Condominium Property Act. The creditor filed a Proof of Claim, in the debtor's Chapter 13 bankruptcy, in the amount of $40,510.01.[14] The debtor objected to this claim.[15] The debtor objected to the assessment of monthly pre-petition late charges, post petition monthly and special assessments and late charges, all attorneys' fees and pre-petition special assessments or fines of $100.00[16]

The Lund court relied on 11 U.S.C. §506(b) to reach its ruling. §506(b) states in relevant part:

To the extent that an allowed secured claim is secured by property the value of which . . . is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest of such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.[17]

Similarly, the court held that attorneys' fees can be included in a proof of claim, under §506(b) if four requirements are satisfied.[18] First, the creditor must have an allowed secured claim. Second, the claim must be over secured. Third, the underlying documents must provide for such fees and costs. Finally, the fees and costs must be reasonable.[19]

The Lund court held that the condominium association could include in its Proof of Claim unpaid pre-petition assessments, unpaid post petition, late charges and certain actual costs, as they are all provided for pursuant to the terms of the parties agreement, the declaration.[20] Certainly, the late charges and charges to the account still must be reasonable to be allowed.[21]

In Lund, the Court did not allow attorneys' fees which were determined to be unreasonable and thus modified the Association's claim.[22] To ensure that a bankruptcy court will overrule any objections by a debtor, a creditor should be sure to include only reasonable fees. The ". . . principle of cost-benefit analysis bears consideration when applying §506(b) . . ."[23] Accordingly, not all fees and costs incurred by an association will be allowed to be

included in a Proof of Claim.

Following Lund, a creditor can also ". . . seek to recover accruing post petition fees, assessments, and expenses within the parameters of §506(b)."[24] Again, the fees and expenses must be reasonable. Like the pre-petition assessments and charges, a creditor can also seek to collect post petition assessments and charges assessed on the parties; underlying agreement, the declaration.

CONCLUSION

An Association must stop all efforts to collect unpaid assessments, once a debtor files bankruptcy, either under Chapter 7 or 13. However, that does not mean that the association should do nothing to protect its interest. It should file a Proof of Claim. It should also continue to assess the appropriate charges against the owner's account. Further, it should continue to monitor the bankruptcy to ensure that it is doing all that is necessary to protect its interest. Finally, when necessary, it should file the appropriate motion to modify the automatic stay. Nonetheless, at all times, the association should complete a cost-benefit analysis and be sure that any fees incurred are reasonable, in light of the amount of the underlying claim. ❺

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1 11 U.S.C.A. §362 (a) (6)
2 11 U.S.C.A. §701 et. seq.
3 11 U.S.C.A. §524 (e)
4 735 ILCS 5/9-101, et. seq.
5 166 B.R.601, 607 (W.D.Pa. 1994)
6 Id.
7 Id.
8 Id. at 608.
9 Id.
10 Id.
11 Id.
12 Id.
13 187 B.R. 245 (N.D.Ill. 1995).
14 187 B.R. at 248.
15 Id.
16 Id. at 249.
17 11 U.S.C.A. §506(b).
18 Id. at 251.
19 Id.
20 Id. at 252-53.
21 Id. at 253.
22 Id. at 259.
23 Id.
24 Id. at 250.