

Surrendering Your Property in Bankruptcy Means You Must Actually Surrender It

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The title of this article seems self-evident. Lenders, servicers, and others active in the foreclosure arena these past few years know that it has been anything but. Borrowers surrender property in bankruptcy but, nevertheless, continue to actively contest foreclosure, sometimes even successfully. Here's a situation that may sound familiar:

- Lender sues to foreclose on mortgaged property. Borrowers deny every substantive allegation in the complaint, including those relating to the loan documents and the default, and raise numerous defenses. The foreclosure action remains pending for months in part because of borrowers' defensive efforts.
- Borrowers then file a Chapter 7 or 13 petition for bankruptcy. In their bankruptcy schedules, borrowers don't dispute the validity of the mortgage, they identify the lender as a secured creditor having an interest in the mortgaged property, and they identify approximately how much the lender is owed.

- Thereafter, in their Chapter 7 statement of intention or Chapter 13 plan for reorganization, borrowers indicate an intention to surrender the mortgaged property. The automatic stay imposed by the bankruptcy court is then lifted or the trustee abandons the property, and the lender proceeds with its foreclosure action.
- Despite surrendering the mortgaged property in the bankruptcy, however, borrowers continue to vigorously defend against the lender's foreclosure action.

The borrowers' actions post-surrender in the above scenario likely seem, to most, inconsistent with their common understanding and usage of the word "surrender." State and federal courts here in Florida, interpreting the meaning of that word as used in the Bankruptcy Code, did not always reach that same conclusion. The Eleventh Circuit has now weighed in on the issue.

***In re Failla* Requires Borrowers that Surrender Their Property to Get Out of the Creditor's Way**

This week, the Eleventh Circuit concluded in *In re Failla*, an opinion designated for publication, that "surrender," as used in section 521(a)(2) of the Bankruptcy Code, means the "giving up of a right or claim" and "requires debtors to drop their opposition to a foreclosure action." 2016 WL 5750666, at *4 (11th Cir. Oct. 4, 2016).

In re Failla involved a Chapter 7 bankruptcy filed by debtors who were opposing an action to foreclose on property they owned. During the bankruptcy proceedings, the debtors admitted that their house was collateral for a mortgage, that the mortgage was valid, and that their property was under water. They filed a statement indicating their intention to surrender the property. The trustee ultimately abandoned the property back to the debtors. When the lender pursued its foreclosure action, the debtors continued contesting it.

The Eleventh Circuit found such conduct irreconcilable with the meaning of "surrender" under section 521(a)(2). That section requires debtors to file a statement of intention, choosing between a few options as to secured property — one of which is surrender. If debtors choose to surrender the property, they must, of course, actually do it. In a Chapter 7 proceeding, a debtor's obligation to fulfill that stated intention, according to the Eleventh Circuit, does not end if the property is surrendered to the trustee and the trustee abandons it. Rather, a debtor must then surrender the property to the secured creditor — a conclusion the Eleventh Circuit says is compelled by the text and context of the statute itself. Practically speaking, that means debtors "must get out of the creditor's way" and not contest the creditor's efforts to foreclose.

How This Impacts Secured Creditors and Practice Tips Moving Forward

In re Failla provides some clarity on the "surrender" issue. Prior to *In re Failla*, federal district courts and bankruptcy courts in Florida disagreed regarding the obligations imposed on borrowers in a foreclosure action after indicating their intention to surrender the property in a bankruptcy

proceeding. A secured creditor arguing this issue in the Bankruptcy Court for the Middle District of Florida could point to *In re Metzler*, 530 B.R. 894 (Bankr. M.D. Fla. 2015), a case in which this firm represented the lender in one of the underlying bankruptcy proceedings. In that opinion, Judge Williamson considered the “relatively novel question” at that time of how a debtor surrenders real property in a bankruptcy and concluded that surrender, whether in a Chapter 7 or 13 proceeding, “at a minimum, require[d] a debtor to relinquish secured property and make it available to the secured creditor.” *In re Metzler*, 530 B.R. at 899. If a debtor failed to do so, the secured creditor probably would be able to reopen the bankruptcy case to address the issue if it did not procrastinate. See *In re Guerra*, 544 B.R. 707, 710–11 (Bankr. M.D. Fla. 2016).

Some Southern District bankruptcy court judges, however, disagreed on the meaning and effect of surrender, at least in the Chapter 7 context. For example, in *In re Elowitz*, 550 B.R. 603, 609 (Bankr. S.D. Fla. 2016) the court compelled Chapter 7 debtors who had filed a statement of intention to surrender property to cease contesting a foreclosure action and surrender the property to the appropriate lienholder. But *In re Elkouby*, 2016 WL 798177, at *8 (Bankr. S.D. Fla. Feb. 29, 2016) held “A chapter 7 debtor who indicates surrender of real property in his statement of intention is not obligated to surrender that property to the lienholder, whether or not the property is administered by the chapter 7 trustee.” Although the District Court for the Southern District of Florida had held that debtors were not permitted to actively contest a foreclosure action following their surrender, *Failla v. Citibank, N.A.*, 542 B.R. 606 (S.D. Fla. 2015), at least one bankruptcy judge declined to follow that decision. See *In re Elkouby*, 2016 WL 798177, at *8.

Finally, if in state court, the one Florida appellate decision on “surrender” aligned itself with the conclusions reached in *Metzler*, providing support for a secured creditor’s position regarding a borrower’s obligations post-surrender. *Rivera v. Bank of Am., N.A.*, 190 So. 3d 267 (Fla. 5th DCA 2016) (concluding that borrower’s surrender of property via bankruptcy proceeding and the bankruptcy court’s order confirming debt and surrender of property while foreclosure appeal was pending fully resolved the matter). The *Rivera* opinion arose out of a Chapter 7 situation, is the only Florida appellate decision on the meaning of “surrender,” and is thus binding on Florida trial courts.

In re Failla settles the disagreement among the Florida federal bankruptcy courts and provides clarity on the “surrender” issue. Secured creditors seeking to foreclose should keep both the *In re Failla* and *Rivera* decisions top of mind when litigating a foreclosure action following a debtor’s filing of bankruptcy.

Ensure that a debtor’s surrender is communicated to those that need to know.

A lender’s bankruptcy counsel should let foreclosure counsel know whether borrowers have surrendered the property in the bankruptcy. Foreclosure counsel should then ensure that a suggestion of bankruptcy is filed in the foreclosure action along with a request for judicial notice of

copies of the debtor’s Chapter 7 statement of intention or Chapter 13 plan for reorganization.

Consider going back to the Bankruptcy Court if needed. As the Eleventh Circuit explained, “Bankruptcy courts have broad powers to remedy violations of the mandatory duties section 521(a) (2) imposes on debtors.” *In re Failla*, 2016 WL 5750666, at *5. Take that statement to heart. If borrowers actively oppose a foreclosure action and pursue their defenses after agreeing to surrender the property in the bankruptcy, a lender will want to assert in state court that the borrower is judicially estopped from doing so. A lender may also want to have the bankruptcy-related issues heard by the bankruptcy court judge, even if there will be some additional, associated costs. In most cases, nothing should prevent a lender from going back to the bankruptcy court to have those issues heard. “[T]here is nothing strange about bankruptcy judges entering orders that command a party to do something in a nonbankruptcy proceeding[,]” including, for example, ordering debtors to dismiss counterclaims and withdraw defenses in a foreclosure action. *Id.*

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