

Client Alert

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Can Chapter 13 Debtor Force a Secured Lender to Accept Title to Collateral in Full Satisfaction of a Secured Claim?

The United States District Court for the District of Massachusetts (the District Court) recently issued an opinion in the *Paul Sagendorph* bankruptcy case reversing the Bankruptcy Court's holding that a debtor can force a secured creditor to take title to its collateral in complete satisfaction of the creditor's secured claim.¹ In reversing the decision of the Bankruptcy Court, the District Court held that the plain language of Sections 1322(b)(9) and 1325(a)(5)(C)² does not empower a debtor to force a secured creditor to accept title to its collateral over that creditor's objection.³

Case Background

Paul Sagendorph (Debtor) is the debtor in a bankruptcy case initiated under Chapter 13 of Title 11 of the United States Code (the Bankruptcy Code) in the United States Bankruptcy Court for the District of Massachusetts (the Bankruptcy Court). Wells Fargo Bank, N.A. (Wells Fargo) is a secured creditor of Debtor with a lien on certain real property (the Property). Wells Fargo filed a proof of claim in the case in the amount of \$61,498.99 secured by a mortgage on the Property. Debtor filed a Chapter 13 Plan (the Plan),⁴ which proposed to satisfy Debtor's secured debt to Wells Fargo by vesting title of the Property in Wells Fargo.⁵ The value of the Property is approximately \$89,000, which is greater than Wells Fargo's secured claim of \$61,498.99.⁶

Wells Fargo did not consent to the vesting provisions, and objected to the Plan on the grounds that Chapter 13 does not authorize forced vesting. Relying on an analogy to Chapter 11,⁷ and by "reading sections 1322(b)(9) and 1325(a)(5)(C) in combination," the Bankruptcy Court reasoned that forced vesting is authorized under Chapter 13.⁸ The Bankruptcy Court therefore contributed to a split in authority regarding forced vesting in Chapter 13 cases.⁹

¹ *Wells Fargo Bank, N.A. v. Sagendorph (In re Sagendorph)*, No. 15-40117-MGM, 2017 U.S. Dist. LEXIS 8962 at *2 (D. Mass. Jan. 23, 2017).

² Section 1322(b)(9) authorizes a debtor to include in a plan terms that provide for *vesting* of property in the debtor or another entity. Section 1325(a)(5)(c), on the other hand, authorizes the court to confirm a plan over the objection of a secured creditor if the plan provides for the *surrender* of the collateral to the secured creditor.

³ *In re Sagendorph*, 2017 U.S. Dist. LEXIS 8962 at *2.

⁴ Chapter 13 of the Bankruptcy Code provides for debtors earning a regular income to obtain relief from debt by proposing a plan which shall provide for the repayment of all or part of debtor's debts over a period of three to five years. See 11 U.S.C. §1322.

⁵ *In re Sagendorph*, 2017 U.S. Dist. LEXIS 8962 at *2.

⁶ *In re Sagendorph*, 2017 U.S. Dist. LEXIS 8962 at *2.

⁷ See *Matter of Sandy Ridge Dev. Corp.*, 881 F.2d 1346 (5th Cir. 1989) (employing Chapter 11's "dirt-for-debt" provision, a forced vesting plan providing for the "transfer of all or any part of the property of the estate to one or more entities," and complying with all other applicable Code provisions may be confirmed); see also 11 U.S.C. § 1123(a)(5)(B) (Chapter 11's provision authorizing "adequate means" for implementation of a plan, by such means as a transfer of property); 11 U.S.C. § 1129(b)(2)(A)(iii) (Chapter 11's provision allowing confirmation of a plan over the objection of a secured creditor so long as the creditor receives the "indubitable equivalent" of its claim, and concluding that indubitable equivalent means transferring to a secured creditor its collateral).

⁸ *Id.*

⁹ Compare *In re Tosi*, 546 B.R. 487 (Bankr. D. Mass. 2016) (reasoning that forced vesting is not authorized under Chapter 13) and *In re Zair*, 2016 U.S. Dist. LEXIS 49032 (E.D.N.Y. Apr. 12, 2016), with *In re Brown*, No. 14-12357-JNF (Bankr. D. Mass. Mar. 4, 2016) *aff'd*, 742 F.3d 1309 (11th Cir. 2014) (authorizing forced vesting in the Chapter 13 context).

The District Court Reverses the Bankruptcy Court's Decision on Appeal

Wells Fargo appealed the decision of the Bankruptcy Court to the District Court, which reversed and remanded the case for further proceedings.

The question addressed on appeal was “whether a surrender of collateral property, as permitted by section 1325(a)(5)(C) of the federal Bankruptcy Code, imposes on secured creditors a requirement to accept vesting of that property.”¹⁰ The District Court therefore narrowed its inquiry to two key points: (1) to determine the meaning of “vest” and “surrender” as they are used in sections 1322(b)(9) and 1325(a)(5)(C) of the Bankruptcy Code; and (2) to determine whether those terms interact to authorize or preclude forced vesting under 1322(b)(9).

The District Court first determined that the definitions of “surrender” and “vesting” are clear and well-established.¹¹ Although “surrender” is not defined in the Bankruptcy Code, the District Court looked to the common law to determine that a “surrender” amounts to the “relinquishment of any rights in collateral,”¹² and that, in the bankruptcy context, a “surrender” amounts to a debtor’s agreement “to make the collateral available to the secured creditor” by “ced[ing] his possessory rights” therein.¹³ Therefore, the District Court defined “surrender” as an “offer to cede property rights to another.”¹⁴

Similarly, “vesting” is not explicitly defined in the Bankruptcy Code. The District Court looked to common law sources to determine the meaning of “vesting,” which “constitutes the acceptance of surrender” and “consummates the legal act of transfer.”¹⁵ Thus, the District Court defined “vesting” as the acceptance of an offer to transfer ownership.¹⁶ As such, the District Court diverged from the Bankruptcy Court in concluding that “vesting” requires the transferee to accept title.

After defining the key terms, the District Court reversed the Bankruptcy Court by concluding that the plain language of the statute does not authorize forced vesting. In this regard, the District Court noted that the Bankruptcy Court impermissibly used the terms “vesting” and “surrender” interchangeably by permitting vesting to satisfy the surrender requirements of 1325(a)(5)(C).¹⁷ The District Court reasoned that using the two terms interchangeably effectively equated the terms.¹⁸ Thus, the District Court reasoned that the Bankruptcy Court’s opinion did not properly give full effect to each term as required.¹⁹ Section 1322(b) provides a list of optional features that a plan may include.²⁰ However, the implementation of any of the optional features is not expressly required under Chapter 13.²¹ Further emphasizing the plain language of the statute, the District Court noted that “nothing in the language of the statute indicates that including one of § 1322(b)’s optional features guarantees the confirmability of the overall plan.”²²

¹⁰ *In re Sagendorph*, No. CV 15-40117-MGM, 2017 WL 327305, at *2 (D. Mass. Jan. 23, 2017).

¹¹ *In re Sagendorph*, 2017 U.S. Dist. LEXIS 8962 at *16-17 (“the Bankruptcy Code must be interpreted by its plain meaning through giving words their ordinary definitions”); *see also, id.* (citing a history of case law, across jurisdictions, arriving at the same definition of “surrender”).

¹² *In re Sagendorph*, 2017 U.S. Dist. LEXIS 8962 at *17 (quoting *In re White*, 487 F.3d 199, 205 (4th Cir. 2007)).

¹³ *In re Sagendorph*, 2017 U.S. Dist. LEXIS 8962 at *17 (quoting *Pratt v. GMAC (In re Pratt)*, 462 F.3d 14, 19 (1st Cir. 2006)).

¹⁴ *In re Sagendorph*, No. CV 15-40117-MGM, 2017 WL 327305, at *6 (D. Mass. Jan. 23, 2017).

¹⁵ *In re Sagendorph*, 2017 U.S. Dist. LEXIS 8962 at *18-19.

¹⁶ *In re Sagendorph*, No. CV 15-40117-MGM, 2017 WL 327305, at *6 (D. Mass. Jan. 23, 2017).

¹⁷ *In re Sagendorph*, No. CV 15-40117-MGM, 2017 WL 327305, at *7 (D. Mass. Jan. 23, 2017) (quoting *Russello v. United States*, 464 U.S. 16, 23 (1983) (“Where Congress uses certain language in one part of a statute and different language in another, it is generally presumed that Congress acts intentionally.”)).

¹⁸ *In re Sagendorph*, No. CV 15-40117-MGM, 2017 WL 327305, at *7.

¹⁹ *Id.* (citing *Landgraf v. USI Film Prods.*, 511 U.S. 244, 259 (1994)).

²⁰ 11 U.S.C.A. § 1322(b)(1)-(11).

²¹ *See* 11 U.S.C.A. § 1322(b)(9) (providing that “the plan may” include any of the listed features) (emphasis added).

²² *In re Sagendorph*, 2017 U.S. Dist. LEXIS 8962 at *21 (quoting *HSBC Bank USA, N.A. v. Zair*, 550 B.R. 188, 202 (E.D.N.Y. 2016)).

The District Court also disagreed with the Bankruptcy Court's justification of forced vesting through a Chapter 11 analogy.²³ In doing so, the District Court further analyzed the plain language of the Bankruptcy Code and underscored the key differences between the language in Chapter 11 with that in Chapter 13. Notably, the District Court gave particular weight to a Chapter 11 provision that "a plan *shall*" provide for vesting, compared with a Chapter 13 provision declaring that a plan "*may* provide for [] vesting."²⁴ The District Court therefore reasoned that "[s]hall" makes section 1123(a)(5)(B) a mandatory provision, one which explicitly identifies transfer of collateral property as a necessarily 'adequate means' of carrying out that mandate."²⁵

Conclusion

The District Court's decision has provided a level of clarity regarding the topic of forced vesting by holding that the plain language of §§ 1322(b)(9) and 1325(a)(5)(C) does not authorize a debtor to convey title to a secured lender over the lender's objection. However, the holding also provides a level of uncertainty surrounding the topic. Although the District Court reversed the holding of the Bankruptcy Court that Chapter 13 permits forced vesting, the District Court discussed the equitable powers of the Bankruptcy Court at length, ultimately remanding the case to the Bankruptcy Court for further proceedings consistent with the opinion. In doing so, the District Court appeared to leave the door open to a potential avenue to forced vesting under a theory of equity.²⁶ The District Court also left unanswered several questions concerning the holding's impact on relevant interactions between state and federal law.

Despite the areas of uncertainty, the District Court's decision furthers an emerging majority opinion in the split of authority regarding forced vesting in the Chapter 13 context. The District Court's opinion also furthers a recent trend of decisions authorizing forced vesting's being overturned on appeal.

Contacts

Jarrett L. Hale
jhale@hunton.com

Tara L. Elgie
telgie@hunton.com

Gregory G. Hesse
ghesse@hunton.com

Christopher Collinsworth
ccollinsworth@hunton.com

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²³ *Id.* at *24.

²⁴ *Id.* at *23-24; *see also*, 11 U.S.C. § 1123(a)(5)(B); *see also*, 11 U.S.C. § 1322(b)(9).

²⁵ *In re Sagendorph*, No. CV 15-40117-MGM, 2017 WL 327305, at *8 (D. Mass. Jan. 23, 2017). We disagree with the District Court's reasoning that § 1123(a)(5)(B) is a mandatory provision. While § 1123(a)(5) does mandate that a plan "shall provide adequate means for the plans implementation," the provision continues with the phrase "such as" followed by a list of ten optional methods of providing adequate means. As such, there is no language in the section that specifically mandates the use of vesting under § 1123(a)(5)(B) to satisfy the "adequate means" for the plan to be implemented required by § 1123(a)(5).

²⁶ *Id.* at *28 ("But given bankruptcy courts' broad equitable prerogative, this court ultimately doubts bankruptcy courts are wholly lacking in authority and ability to balance the equities in a situation that includes forced vesting under Chapter 13.")