Appeal No. 16-35384

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PENNY D. GOUDELOCK,

Appellant,

v.

SIXTY-01 ASSOCIATION OF APARTMENT OWNERS,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WASHINGTON
HONORABLE MARSHA J. PECHMAN
CASE NO. 2:15-CV-01413-MJP

BRIEF OF AMICUS CURIAE CAI

By Brian R. Fellner
Nagle & Zaller, P.C.
7226 Lee Deforest Drive, Suite 102
Columbia, Maryland 21046
(410) 740-8100 x110
brian@naglezaller.com

Attorneys for Amicus Curiae CAI

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

INTRODUCTION

Amicus curiae the Community Associations Institute ("CAI") is an international membership organization dedicated to building better communities with more than 34,000 members. Permission to file this amicus brief was granted by counsel for Appellant; all parties have consented to the filing. CAI hereby files this amicus brief in support of Appellee and requesting that the Court affirm the decision of the District Court below. The decision of the District Court below was in accord with the Bankruptcy Appellate Panel of the Ninth Circuit, as well as several other courts across the country. It also results in the most harmonious reading of the Bankruptcy Code and state homeowners association and covenant laws together, and it reflects the clear intent of Congress when enacting the relevant statutory provisions.

The membership of CAI consists of community associations around the globe who provide all types of services to their owners, from trash removal to snow plowing to roof maintenance and more. The community associations rely on their assessments from each constituent property as the life blood to permit them to provide these services. Community associations are constrained by the fact that their budgets are completely inelastic; if one of the constituent properties does not pay its share of the assessments, there is a corresponding reduction in services provided across the board. For this reason, their governing documents are often constructed in such a way that the expected return on collections is 100%. There are late fees, interest, and legal fees to be recovered from delinquent debtors to replace that amount in the budget. The association can pursue the debtor personally even if the property is foreclosed and the liens are severed. And the debt is secured by a lien against the property that survives Chapter 7 bankruptcy and makes the association a secured creditor for the purposes of Chapter 13 bankruptcy. The clear message is that the association can and will pursue the assessments via all available means.

Appellant here makes an argument inconsistent with that theory: she claims that she can discharge the post-petition Chapter 13 personal obligation to pay assessments while still remaining on title to the property. This argument must be rejected for several reasons. First, the discharging the post-petition assessments is inconsistent with most state laws, including the relevant laws of Washington in this case. Second, discharging the post-petition assessments does not only provide the debtor with a "fresh start;" it provides her with benefits that are impermissible and inconsistent with the spirit of the bankruptcy. Third, the Bankruptcy Code does not provide for the discharge of post-petition assessments. Fourth and finally, the doctrine of federal preemption does not apply to the post-petition assessments. Because the District Court ruling was consistent with these principles, Amicus Curiae CAI suggests that this Honorable Court affirm the ruling below.

ARGUMENT

I. DISCHARGING THE POST-PETITION ASSESSMENTS IS INCONSISTENT WITH STATE LAW

Homeowners association assessments, and property ownership generally, are governed by state law. Appellant here is asking the Court to relieve her of any obligation to pay those assessments once she has filed a Chapter 13 bankruptcy and "surrendered" the property. However, there are significant state law issues of property rights and property ownership that would be violated by such a holding.

A. SURRENDER HAS NO OPERATION OF LAW

The debtor argues that because she "surrendered" the property under her Chapter 13 Plan, that she should not have to pay post-petition assessments or otherwise be obligated to deal with the property. But this simply assigns a greater weight to the "surrender" than it actually has under the law. Congress did not define what surrender entails, and courts have struggled to decide: "the word 'surrender' means the relinquishment of all rights in the property, including the possessory right, *even if such relinquishment does not always require immediate physical delivery of the property to another*." *In re Plummer*, 513 B.R. 135, 143-144 (Bankr. M.D. Fla. 2014)(emphasis added). In fact, courts have rejected the ability of a debtor to vest ownership of property in a secured creditor lender precisely *because* it would impose these same ownership obligations illegally. *See e.g. HSBC Bank USA, N.A. v. Zair*, 550 B.R. 188, 204 (2016).

However, what is universally agreed is that it has no operation of law whatsoever; that is, it does not grant or sever any property or ownership rights: "Though the Code provides debtors with a surrender option, it does not force creditors to assume ownership or take possession of collateral. And although the Code provides a discharge of personal liability for debt, it does not discharge the ongoing burdens of owning property. *Cf. Foster v. Double Ranch Assn. (In re Foster)*, 435 B.R. 650, 653 (9th Cir. BAP 2010) (Post-petition condominium homeowners' association fees accrue as an incident of debtor's continuing ownership and are not dischargeable in Chapter 13)." *In re Canning*, 442 B.R. 165, 172 (Bankr. D. Me.), *aff'd*, 462 B.R. 258 (B.A.P. 1st Cir. 2011), *aff'd but criticized*, 706 F.3d 64 (1st Cir. 2013).

In order to convey a property right, the debtor would have to do something. Under 11 USC § 1327(b), "the confirmation of a plan vests all of the property of the estate in the debtor." Simply surrendering the property does not remove the debtor as the owner. In fact, it does nothing other than indicating her intent. Debtor attempts to argue that by uttering certain "magic words," that she has made her Chapter 13 bankruptcy able to impact property rights. In fact, "surrendering" the property does nothing, and it should not impact dischargeability of debts either.

B. UNOWNED PROPERTY

If the debtor's requested relief were granted, and she were discharged from paying post-petition assessments, it would be as if the Court were removing her as owner of the property without replacing her with another owner. This once again would be a situation inconsistent with state law. Whether the owner dies, or is defunct corporate entity, or cannot be located, that owner still remains the title owner of the relevant property under state laws. If a conveyance is found to be fraudulent, the property reverts to the prior owner. If no owner can be determined or located, the property reverts to the state. But there is *always* an owner named on title.

By removing the obligation to pay assessments, and thus effectively removing the owner from title, the bankruptcy would be creating a host of additional problems. Who is responsible for utilities provided to the property during this time period? Who liable if someone is injured on the property? While this opinion only addresses the discharge of the regular monthly assessments, what happens if a special assessment to fix an essential part of the community is levied? It is clear that the property cannot go on indefinitely without an owner simply because the debtor hoped it would be true in the bankruptcy. The owner must affirmatively remove herself from title to effect the transfer of property and remove her assessment obligation.

C. SURRENDER TO MULTIPLE CREDITORS

A further problem with the theory advanced by Appellant is that the "surrender," even if it were possible in the fashion she advocates, can only be made to one creditor. That is, only one creditor can actually take title to the property. But if, as here, there are multiple secured creditors, and the debtor simply indicates an intent to surrender the property, it gives none of the secured creditors any actual understanding of how their rights to the property will be treated. The lender and the homeowners association both have the right to foreclose; they both have the right to sell the property and/or purchase it at auction. The plan that simply says "surrender" does not indicate to whom it is surrendered, or how their rights should be addressed and divided up. Such a proposition is wholly inconsistent with the claim that post-petition obligations are also discharged against the debtor. If they were to be discharged, then there would have to be some much more clear interpretation of the property rights of secured creditors. Without it, the "magic words" of surrender cannot operate to extinguish a post-petition obligation.

D. UTILITIES

The payment of utilities for a piece of real property is analogous to the homeowners association assessments. While the original agreement and obligation to pay arose pre-petition, the services provided to the property (and thus the owner of the property) continue on after the petition.

Courts have considered the post-petition obligations of property owners when it comes to utilities, and have proceeded logically to the conclusion that failure to make post-petition payments allows for termination of services without requesting permission from the bankruptcy court. *In re Jones*, 369 B.R. 745, 749 (B.A.P. 1st Cir. 2007). The court in *Jones* reviewed a situation where the utilities continued to be furnished after the filing of the Chapter 13 and while the stay was in place. That court held:

> We conclude that adoption of the argument that any act to collect a post-petition debt from a Chapter 13 debtor would implicate the automatic stay, would signify that post-petition creditors could not submit invoices to a debtor without relief from the automatic stay since it would clearly be an attempt to collect the post-petition debt and the funds would come from the debtor's post-petition income. Post-petition creditors providing a Chapter 13 debtor with goods or services are permitted to invoice debts as they come due and payment by the Chapter 13 debtor from post-petition income does not require authorization by the Court.

Id. Once again, the distinction between pre-petition debt and post-petition debt is observed, *even when the original obligation arose prior to the petition*. The services were provided post-petition, and the court there held that not only could the utility creditor pursue those amounts, but that they did not even have to lift the automatic stay to do so: "[w]e conclude that a utility does not run afoul of the automatic stay provisions in a Chapter 13 bankruptcy case by terminating service based on a debtor's failure to pay for post-petition service." Utilities are services that arise pre-petition but are services that continue post-petition, just like homeowners association assessments. If they can be pursued post-petition, then there is little rationale to support discharging all post-petition assessments.

II. DISCHARGING THE POST-PETITION ASSESSMENTS RESULTS IN AN IMPERMISSIBLE BENEFIT FOR THE DEBTOR – INEQUITABLE

The argument regarding the "fresh start" for the debtor treats the continuing ownership of property as solely a burden, without any benefit. It fails to take into account that the debtor still may avail themselves of the property, including living in it, renting it, borrowing against it, and more. The "surrender" in the Chapter 13 Plan indicates the debtor's *intent only*; it does not sever any of those rights. While the debtor may or may not have *availed* themselves of those rights, they continued to exist and belong solely to the debtor. Thus, the post-petition assessments may not be discharged, as it would lead to an inequitable result.

A. DISCHARGE POST-PETITION BUT KEEP PROPERTY

The problem with the discharge of post-petition assessments can be clearly seen from the following scenario: the debtor files Chapter 13 and discharges the post-petition assessments, stating that they will surrender the property. The debtor then pays the mortgage instead, removing the lien of the mortgage holder and giving the debtor clear title to the property. Under Appellant's requested holding in this case, that debtor now owns the relevant property but has no personal obligation to pay homeowners association assessments. This result plainly demonstrates the impermissible nature of the relief Appellant requests; discharging post-petition assessments would be an illegal taking of a right held by the homeowners association to collect its assessments from the title owner.

Furthermore, by discharging the assessment obligation, the bankruptcy is arguably discharging the other covenants contained within the association's governing documents as well. If the owner is no longer obligated to pay assessments, they could easily argue that they are not obligated to submit an architectural application before erecting a shed, or that they are not bound by the prohibition on pets contained in the governing documents. The personal obligation that the debtor is discharging is clearly only the *assessments that came due prior to the bankruptcy filing*; to hold otherwise is in direct contrast with the law and leads to untenable results.

B. CAN CONTINUE TO LIVE/RENT – NO OBLIGATION TO LEAVE

The rule proposed by the Appellant places undue significance on the word "surrender" in the plan. In reality, it does not obligate the debtor to do anything, nor does it allow or enable the creditor to take any action. Even when the debtor marks "surrender" on her Chapter 13 plan, she may continue to live or rent the property for years. That places no affirmative obligation on her to leave, and in fact courts have not determined what if anything it requires of the debtor. The unfortunate situation is that "[w]here property is surrendered in a Chapter 13 plan, there is often an 'expectation' that the creditor will promptly enforce its rights… at times, creditors may fail to exercise these rights, leaving debtors stuck with the collateral and responsible for the maintenance, taxes, and other obligations that come with owning the property." *HSBC Bank USA, N.A. v. Zair*, 550 B.R. 188, 200 (2016) (internal quotes omitted). The clear result of that analysis is that the debtor still *does* own the property and thus keeps *both the benefits and the obligations of ownership*.

The reason that debtors such as Appellant are raising the issue and requesting a "fresh start" years later is because this was not properly explained to them at the time of their bankruptcy filing. They incorrectly held the "expectation" cited above that the lender bank would immediately take title. But this incorrect understanding of the law should not interfere with the homeowners association's rights as a creditor post-petition. Bankruptcy attorneys and trustees would benefit from a clear resolution of this dispute so that they may appropriate advise their clients/debtors.

Reviewing a situation where the debtor attempted to discharge post-petition attorneys' fees pursuing a pre-petition claim, the court in *In re Ruben*, 774 F.3d 1138, 1141 (7th Cir. 2014) said: "A principal goal of bankruptcy is to provide the debtor with reasonable exemptions and a fresh start… The balance must be struck so that post-bankruptcy acts on the part of the debtor cannot be undertaken with impunity. This follows from the general principle that only liabilities arising from pre-petition acts are discharged in bankruptcy." The balance must similarly be struck here. A pre-petition legal issue that results in further post-petition legal costs is an excellent parallel to the present situation. The case arose prior to the bankruptcy, just as home ownership did here. However, the need to maintain the legal claim continued on, just as the need to maintain the property does here. The debtor may not discharge obligations that continue and survive after the bankruptcy.

C. GOVERNING DOCUMENTS PROHIBIT DISCLAIMING

Community association documents and state legislation regularly contains a provision stating that the owner of a property may not exempt himself from liability for his contribution to the common expenses by waiving or disclaiming his rights or enjoyment of the common areas, or by abandoning the relevant property. Courts have generally upheld these provisions. *See*, e.g. *Glen v. June*, 344 N.J. Super. 371, 376, 782 A.2d 430, 433 (App. Div. 2001); *In re Raymond*, 129 B.R. 354, 362 (Bankr. S.D.N.Y. 1991); *San Antonio Villa Del Sole Homeowners Ass'n v. Miller*, 761 S.W.2d 460, 464 (Tex. App. 1988).

That is exactly what Appellant has attempted to do here; she simply calls is "surrender" under the Bankruptcy Code. But neither the statute nor her unilateral actions are sufficient to relieve her of her contractual obligation to pay the assessments. Furthermore, these are state law contract and covenant claims, and thus should not and cannot be superseded by the debtor's bankruptcy filing.

III. THE BANKRUPTCY CODE DOES NOT PROVIDE FOR DISCHARGE OF POST-PETITION ASSESSMENTS

Appellant's argument regarding congressional silence as to the applicability of 11 U.S.C. § 523(a)(16) does not succeed here because it turns the argument on its head. In order to discharge post-petition obligations (or any other amounts), there must be an affirmative and demonstrated intent to do so. To say that because Congress did not mention it implies that they meant to leave it out is backwards; if Congress meant to discharge post-petition homeowners association assessments, they would have explicitly included them in the discharge list. As this Court has stated: "divin[ing] congressional intent from congressional silence" is "an enterprise of limited utility that offers a fragile foundation for statutory interpretation." Polar Bear Prods., Inc. v. Timex Corp., 384 F.3d 700, 717 (9th Cir. 2004).

The Ninth Circuit Bankruptcy Appellate Panel recently issued a decision in *In re Batali*, BAP No. WW-14-1557-KiFJu (2015) that, while not binding or precedential, contains the same persuasive rationale. The court there followed *In re Rosenfeld*, 23 F.3d 833 (4th Cir. 1994), which held that an association's debt is contingent upon continued ownership of the property, and thus the post-petition debt is a continuing obligation that is not discharged by bankruptcy.

IV. FEDERAL PREEMPTION DOES NOT APPLY

The Supremacy Clause of the United States Constitution (Art. VI, cl.2) allows federal courts to preempt state laws that "interfere with, or are contrary to," federal law. *Hillsborough County v. Automated Med. Labs., Inc.*, 471 U.S. 707, 712 (1985)(citation omitted). A court should not decide a constitutional issue unless it is necessary to dispose of the matter before it. *Harmon v. Brucker*, 355 U.S. 579, 581 (1958); *Ashwander v. Tennessee Valley Auth.*, 297 U.S. 288, 347 (1936). Put another way, there should be a good reason to find preemption of otherwise valid state law. There is none here.

A constitutional challenge based upon preemption can only be successful if the challenger demonstrates that the state law can *never* be applied consistent with federal law. *City of Chicago v. Morales*, 527 U.S. 41, 55 & n.22 (Stevens, J., joined by Souter, and Ginsburg, J.J.), 527 U.S. at 69-70 (Breyer, J., concurring) (1999). Where it is possible to apply state law consistent with federal law, a facial preemption challenge must fail. See *California Coastal Comm'n v. Granite Rock Co.*, 480 U.S. 572, 588 (1987) (where state law may be applied consistent with the federal law, facial preemption challenge fails); *Chemical Specialities Mfrs. Ass'n, Inc. v. Allenby*, 958 F.2d 941, 943 (9th Cir. 1992) (same). It is reversible error to decide the question of preemption where the case can be resolved on state law claims. *Bell Atl. Md. v. Prince George's County,* 212 F.3d 863, 865 (4th Cir. 2000).

Where federal law allegedly bars state action in an area of traditional state regulation, courts apply a presumption against preemption. *Hillsborough County*, 471 U.S. at 715 (congressional intent to preempt "must be clear and manifest"). Even where a statute explicitly preempts state law, courts must apply the presumption to minimize preemption to the level contemplated by Congress. *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996) (citation omitted); see also, *City of Abilene v. FCC*, 164 F.3d. 49, 52 (D.C. Cir. 1999) (§253(a) does *not* compel intrusion into an area of traditional State sovereignty.) The Bankruptcy Code indicates no intention to pre-empt state covenant laws. For an implied pre-emption to be found, generally, the test of whether both federal and state regulations may operate, or the state regulation must give way, is whether both regulations can be enforced without impairing the federal superintendence of the field, not whether they are aimed at similar or different objectives. *Florida Lime and Avocado Growers, Inc. v. Paul,* 373 U.S. 132, 142, 83 S.Ct. 1210, 1217, 10 L.Ed.2d 248 (1963).

The Supreme Court has been reluctant to find an implied pre-emption of state regulation of public utilities, such as railroads, by particular bankruptcy provisions. See *Palmer v. Massachusetts,* 308 U.S. 79, 60 S.Ct. 34, 84 L.Ed. 93 (1939). Condominiums, homeowners associations, real property covenants running with the land, private contracts, and the collection of debts are all traditionally state arenas similar to the utilities. By claiming that bankruptcy law preempts the states' well-established authority these matters, Appellant is making an argument inconsistent with federal preemption doctrine.

V. CONCLUSION

For all the above reasons, this Court should affirm the decisions of the Bankruptcy Court and the District Court by finding that the post-petition assessments assessed against the Debtor were not discharged. This Court should further hold that post-petition condominium or homeowners association assessments may not be discharged by a Chapter 13 bankruptcy. To do otherwise would run afoul of federal and state law, as well as crippling homeowners associations and condominiums due to actions that were beyond their control to prevent or address.

VI. STATEMENT OF RELATED CASES

CAI is aware of no related cases pending before this Court.

Dated this 21 day of December, 2016.

Respectfully submitted,

By: /s/ Brian R. Fellner

Brian R. Fellner
Nagle & Zaller, P.C.
7226 Lee Deforest Drive, Suite 102
Columbia, Maryland 21046
brian@naglezaller.com

Counsel for Amicus Curiae CAI

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December 21, 2016

/s/ Brian R. Fellner
Signed: Brian R. Fellner

AUTHORSHIP AND FUNDING OF AMICUS BRIEF

Pursuant to Fed. R. App. P. 29(a)(4), no counsel for a party authored this brief in whole or in part, and no person or entity other than CAI, its members, and its counsel, made any monetary contribution toward the preparation or submission of this brief.

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