Client Alert

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Mortgage Reaffirmation Agreements, Credit Reporting and the Discharge Injunction: Recent Bankruptcy Court Decision Reveals Underlying Tensions

Current industry practice is that many mortgage lenders report discharged debt as having a "zero balance," indicating that the consumer is no longer personally liable for the debt, and cease reporting subsequent payments. Most mortgage lenders will report payments to the credit bureaus only if the debtor reaffirms the mortgage loan while in bankruptcy. Debtors have alleged, among other claims, violations of the discharge injunction for the failure of mortgage lenders to report payments on discharged mortgage debt that is not reaffirmed. To date, all bankruptcy courts to consider the issue have ruled in favor of the mortgage lenders.

Recently, a bankruptcy court considered a related, but slightly different, question of whether a mortgage lender's *conditioning* of credit reporting on reaffirmation of the mortgage debt—that is, making a direct statement to the debtor requiring that the debtor reaffirm the debt as a prerequisite for the mortgage lender to report payments to the credit bureaus—violated the discharge injunction or other applicable law. Although the court ultimately declined to find a violation, the court's raising of the issue *sua sponte* is an important signal for mortgage lenders that bankruptcy judges are scrutinizing the role of reaffirmation agreements and credit reporting as they relate to the bankruptcy discharge and the notion of a "fresh start" for a debtor.

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The Bankruptcy Code allows debtors who desire to retain their primary residence to continue making mortgage payments and discharge their personal liability on the debt. This is known as the "ride through" or "stay and pay" option. In certain circumstances, debtors may reaffirm the mortgage debt, which maintains their personal liability, often in exchange for a modification of the loan. Although a debtor may continue making payments during and after bankruptcy, mortgage lenders generally do not report the payments to the credit bureaus absent reaffirmation because the debtor no longer will be personally obligated on the mortgage loan as a result of the bankruptcy discharge.

In a recent case, in support of a request to approve a reaffirmation agreement of mortgage debt, one of the debtors filed an affidavit that stated that she had complained to the mortgage lender that she was not receiving statements and that her timely mortgage payments were not being reported to credit agencies. She also alleged that the mortgage lender had refused to report her timely mortgage payments to the credit bureaus unless the mortgage debt was reaffirmed.[1] *Sua sponte* in response to the affidavit, the bankruptcy court ordered briefing on the issue of whether the mortgage lender's action was improper, including whether it had violated the discharge injunction or the Fair Debt Collection Practices Act (FDCPA) and Fair Credit Reporting Act (FCRA).[2]

[1] *See In re Canella*, No. 8-16-70319-ast 2017 Bankr. LEXIS 1125 (Bankr. E.D.N.Y. April 18, 2017).
[2] *See id.* at *2-3.

In their brief, the debtors conceded that the discharge of debt leaves a creditor with no alternative but to report a zero balance for that debt. The debtors also acknowledged that federal courts addressing allegations that failing to report payments on discharged debt violated the discharge injunction all ruled in favor of the mortgage lenders.[3] However, the debtors argued that these courts did not address whether the mortgage lender violated the discharge junction or other applicable law by *conditioning* the reporting of payments on discharged debt on the reaffirmation of such debt. The debtors did not cite any cases, which suggests that this is a novel argument.[4]

In its brief, the mortgage lender argued that it was not required to report the postbankruptcy payments on the mortgage loan since the debtors' personal obligations were discharged. To the contrary, the lender argued that the act of reporting mortgage payments without a court-approved reaffirmation agreement could violate the discharge injunction. The mortgage lender did not directly address the debtors' nuanced argument that it violated the discharge injunction by *conditioning* the credit reporting on reaffirmation of the debt.

Citing the lack of legal authority and absence of sufficient factual allegations presented by the debtors, the bankruptcy court declined to reach a decision on the issue framed by Mrs. Cannella's affidavit.[5] In response to the claim that the mortgage lender violated the discharge injunction by making the statement to Mrs. Cannella that it would not report her payments unless she reaffirmed the debt, the court noted that the debtors appeared to argue that the lender *could* have violated the discharge injunction, but did not "posit an actual claim for a discharge violation."[6] The bankruptcy court then declined to approve the reaffirmation agreement because of the presumption of undue hardship based on the debtors' negative monthly income.[7]

Bankruptcy courts have historically frowned upon reaffirmation of mortgage debt due to the lack of a perceived benefit for the debtor absent a loan modification or other concession from the lender.[8] A debtor can "stay and pay" postdischarge without reaffirming the debt, thereby avoiding the continued personal liability while maintaining possession of the primary residence. Without the ongoing mortgage payments reflected on the debtor's credit report, the debtor may have difficulty refinancing and purchasing a new residence. Some bankruptcy courts have acknowledged the potential benefit credit reporting provides and have allowed debtors to reaffirm mortgage debt, even in some jurisdictions by reopening previously closed cases.[9]

The question of whether conditioning something that a mortgage lender is not otherwise required to do on reaffirming a debt could violate the discharge injunction appears to be one of first impression. The discharge injunction prevents any act to collect discharged debt. There is no formulaic test for what constitutes an "act" to collect a discharged debt. It is largely a matter of the court "knowing it when it

[3] *See*, e.g., *Groff v. Wells Fargo Home Mortg.*, 108 F. Supp. 3d 537 (E.D. Mich. 2015) (holding that defendant mortgage lender's reporting of discharged debt as "zero balance/zero payment" when debtor continued making payments but did not reaffirm the debt in bankruptcy did not violate FCRA); *Schueller v. Wells Fargo & Co.*, 559 Fed. App'x 733 (10th Cir. 2014) (same).

[4] The debtors did cite to *Watkins v. Guardian Loan Co. (In re Watkins)*, 240 B.R. 668 (Bankr. E.D.N.Y. 1999). That case involved a licensed lender under New York law that conditioned a new loan on the debtors' agreement to repay a portion of previously discharged debt without seeking court approval of a reaffirmation agreement. The bankruptcy court held that, in so doing, the lender violated the discharge injunction.

[5] *In re Cannella*, 2017 Bankr. LEXIS 1125 at *3.

[6] *Id.* at *4.

[7] *See* 11 U.S.C. § 524(m).

[8] *See*, e.g., *In re Pope*, 10-19688-RGM, 2011 Bankr. LEXIS 655 (Bankr. E.D. Va. Feb. 17, 2011).

[9] Tennessee is one such example, according to reports from local attorneys practicing in that jurisdiction. However, it is questionable whether it is appropriate to reopen a case to approve a reaffirmation agreement because of the Bankruptcy Code's requirement that a court approve the reaffirmation prior to entry of the discharge. *See In re Owens*, No. 10-72509, 2013 Bankr. LEXIS 3279 (Bankr. W.D. Va. Aug. 9, 2013) (noting that Bankruptcy Code § 524(c)(1) requires a court to approve a reaffirmation agreement prior to discharge).

smells it."[10] The cases are fact-intensive. For example, in one case where a court ruled that no discharge violation occurred, the court noted that it was significant that it was not the creditor that contacted the debtors, but the debtors who initiated contact to request removal of information from their credit reports.[11] In another case, a bankruptcy court held that it was improper for a lender to condition consideration of a loan modification on entry into a reaffirmation agreement.[12]

At least one court has held that the act of credit reporting by a furnisher of credit information, such as a mortgage lender, does not by itself run afoul of the discharge injunction (but could run afoul of other applicable laws).[13] As one court held, "the mere reporting of credit information about a debtor *vel non* is not an 'act' to collect a discharged debt within the meaning of the [Bankruptcy Code], unless the evidence shows … that there is a linkage between the act of reporting and the collection or recovery of the discharged debt."[14] The corollary to that holding is that the nonreporting of voluntary payments on discharged debt, which is current industry practice and not required by otherwise applicable law, would not, without some additional act, violate the discharge injunction either.

Nonetheless, there is tension between the general disfavor of bankruptcy judges to approve the reaffirmation of mortgage debt and the benefits to a debtor of credit reporting of mortgage payments on discharged debt. It appears that bankruptcy judges are taking note of the benefits credit reporting has when a debtor attempts to refinance or take on additional debt postdischarge. The only way to realize the benefits of credit reporting of postdischarge mortgage payments is to reaffirm the debt, which would make the debtor personally liable notwithstanding the discharge. As a result, mortgage lenders should expect bankruptcy courts to give closer scrutiny to communications by lenders to debtors about credit reporting, particularly where such communications also reference reaffirmation of the debt. While the current case law indicates that it would be unlikely for a bankruptcy court to find a violation of the discharge injunction based on the facts discussed above, determinations of discharge violations are fact-intensive and often ones of degree with few clear rules.[15] This developing area of the law bears monitoring. In the meantime, mortgage lenders should exercise caution about making *quid pro quo* statements to debtors about reaffirming dischargeable mortgage debt, particularly when the lender initiates the contact with the debtor.

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[10] *Id.*
[11] *See In re Vogt*, 257 B.R. 65, 70 (Bankr. D. Colo. 2000).
[12] *See In re Pope*, 10-19688-RGM, 2011 WL 671972 (Bankr. E.D. Va. Feb. 17, 2011). The court in *Pope* did not consider whether such conditioning was a violation of the discharge injunction.
[13] It is critical to note that reporting discharged debt to credit bureaus could expose a mortgage lender to claims for alleged violations of the FDCPA, FCRA or other applicable law that prohibits creditors from reporting inaccurate information about consumer debts.
[14] *In re Mahoney*, 368 B.R. 579, 584 (Bankr. W.D. Tex. 2007).
[15] *Id.* at 584.