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## CONDOMINIUM ASSESSMENTS IN BANKRUPTCY: THE CURIOUS CASE OF THE VANISHING ASSESSMENT

### INTRODUCTION

On June 17, 1988, Steven and Sheri Cohen purchased a condominium in the North Park Parkside condominium complex located in San Diego, California.<sup>1</sup> When they purchased their unit, they became members of the North Park Parkside Community Association, and became bound under the development's Covenants, Conditions and Restrictions ("CC&R"). Among the duties prescribed for North Park owners was the obligation to pay the condominium fee assessments. The CC&R spelled out that failure to pay the assessment could result in a lien against the property.

The Cohens' financial status took a rapid turn for the worse. By December 1988, the first trust deed<sup>2</sup> holder had initiated foreclosure proceedings on the property. On December 28, 1988, the Cohens filed for protection under Chapter 7 of the Bankruptcy Code.<sup>3</sup> Since there was no equity in the property, they could not assert exemptions.<sup>4</sup> The Cohens received a discharge in their bankruptcy on April 28, 1989. On the same day, the trust deed holder received relief from the automatic stay, and was allowed to proceed with foreclosure.<sup>5</sup> The Cohens remained in possession of their condominium unit until the trust deed holder foreclosed on September 28, 1989.

North Park levied a homeowner's assessment for all its members on June 1, 1989 for the period January 1, 1989 to June 1, 1989. When the Cohens failed to pay their assessment, North Park filed a state court collection action. The Cohens did not respond. North Park took a default judgment for \$1,445.06 on March 30, 1990.

When North Park scheduled a judgment debtors' examination, the Cohens sought an order of contempt from the Bankruptcy Court against North Park for violating the discharge injunction under section 524.<sup>6</sup> The

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1. The facts of this introduction are drawn from *Cohen v. North Park Parkside Community Ass'n (In re Cohen)*, 122 B.R. 755 (Bankr. S.D. Cal. 1991).

2. The principal form of real property security agreement in California is the trust deed. This Comment uses the phrases "mortgage" and "trust deed" interchangeably.

3. 11 U.S.C. § 701 *et seq.* All references to statute in this Comment are to the Bankruptcy Code ("the Code"), unless specified otherwise.

4. Section 522(d)(1) allows a debtor to exempt some homestead equity from the bankruptcy estate. *See infra* note 46 and accompanying text.

5. Under section 362, any actions to take the debtor's property—including foreclosure proceedings—are stayed once the bankruptcy petition is filed. *See infra* note 18 and accompanying text.

6. Section 524 provides that a discharge in bankruptcy acts as an injunction against any effort to collect a pre-petition debt. *See infra* note 24 and accompanying text.

Cohens' took the position that accepting the CC&R gave rise to a contingent liability for homeowners' assessments. This contingent liability arises pre-petition,<sup>7</sup> so it is subject to the discharge. North Park asserted that the duty to pay assessments ran with the land, and only arose when the assessment was levied. Therefore, the debt was post-petition, and did not fall within the scope of the discharge.

In the Cohens' case, the Bankruptcy Court adopted the debtors' position. In doing so, the Court was in accord with ten other published opinions. However, had the court adopted the Association's position, it would have found support in nine published decisions.<sup>8</sup> In short, whether post-petition condominium assessments are dischargeable in bankruptcy depends mainly on where the debtor files his petition.

This Comment explores the basis and ramifications of this split between districts. First, the Comment presents a brief overview of proceedings under the Bankruptcy Code. Next, the Comment reviews cases concerning discharge of condominium assessments<sup>9</sup> in Chapter 13 debtor rehabilitation cases. The Comment then discusses cases holding that post-petition condominium assessments should not be discharged under Chapter 7, because the obligation to pay assessments runs with the land. A discussion follows of cases taking the opposite position on the grounds that, regardless of the assessment date, the assessment has its roots in a pre-petition transaction. In the process, the Comment considers what the proper positions should be to unravel this conflict between bankruptcy and real property law. Next, in the absence of pertinent case law, the proper position in a Chapter 11 reorganization is considered. Finally, the Comment concludes with some thoughts on changes in the Bankruptcy Code which could clarify this situation.

## I. AN OVERVIEW OF BANKRUPTCY LAW

### A. Background

A review of bankruptcy law and procedure properly begins with consideration of the two underlying goals of American bankruptcy law. On the one hand, bankruptcy under the Code seeks to provide "a fresh start for the honest but unfortunate debtor."<sup>10</sup> The rationale is credit is the engine

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7. I.e., before the filing of the bankruptcy petition.

8. The respective decisions on both sides of the issue are listed in Appendix A.

9. Throughout this Comment, the term "condominium" means any form of land ownership which is subject to an Owner's Association assessment. Thus, "planned unit development" and "co-operative" are included within "condominium."

It should be noted at the outset that most of the published opinions on this subject deal with an assessment which impedes the debtor's exemptions under § 522. Thus, any assessment lien is avoided; *in rem* liability is not at issue, and personal liability becomes the central question. See *infra* note 48.

10. *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934); see also *Grogan v. Garner*, 111 S. Ct. 654, 659 (1991).

of the American economy. Holding a person or entity to a debt which it is simply unable to pay prevents it from moving forward as an active participant in the national business life. "[A] central purpose of the Code is to provide a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy 'a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.'"<sup>11</sup>

On the other hand, the Bankruptcy Code seeks to provide a fair distribution of the debtor's assets to its creditors.<sup>12</sup> By definition, bankruptcy rarely arises where there are sufficient assets to pay all creditors.<sup>13</sup> Bankruptcy under the Code provides a mechanism for prioritizing the debtor's obligations, and prevents a "race to the courthouse" for priority.<sup>14</sup> Instead of allowing creditors to pick at a debtor piecemeal, the bankruptcy process offers creditors a rational framework for considering their claims.

### *B. Rudiments of Procedure Under the Bankruptcy Code*

Whether the goal of a bankruptcy case is liquidation, reorganization or debtor rehabilitation, there are common elements in the initiation of any bankruptcy case. Filing a bankruptcy petition triggers several events. First, it invokes federal jurisdiction. The federal district court where the bankruptcy was filed automatically has jurisdiction over most civil cases against the debtor, wherever they exist.<sup>15</sup> Second, when a petition is filed, all the debtor's assets become part of a separate entity known as the "bankruptcy estate."<sup>16</sup> The estate is the resource which is used to pay the pre-petition debts. Third, since the debtor's former assets are now property of the estate,<sup>17</sup> the Code provides debtors with protection from their creditors. Section 362 provides a stay against an extremely broad spectrum

11. *Grogan v. Garner*, 111 S. Ct. at 659 (quoting *Local Loan Co. v. Hunt*, 292 U.S. at 244).

12. *Kothe v. R. C. Taylor Trust*, 280 U.S. 224, 227 (1930); *Lane Bryant v. Vichelle Tops, Inc.* (*In re Vichelle Tops, Inc.*), 62 B.R. 788, 792 (E.D.N.Y. 1986).

13. Under the Code, it is possible to have sufficient assets to pay all allowed claims and return some of the estate's property to the debtor at the close of the bankruptcy. Clearly, this is a rare occurrence. See § 726(a)(6) (Debtor has last priority in distribution of estate).

14. See *infra* notes 55-57.

15. 28 U.S.C. § 1334(b) provides, in pertinent part, "[T]he district courts shall have . . . jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11." 28 U.S.C. § 157 allows the district courts to refer any bankruptcy-related matters to the bankruptcy courts. Under 28 U.S.C. § 151, the bankruptcy courts are "a unit of the district court . . ."

16. Section 541(a) states, "The commencement of a case . . . creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held: (1) [A]ll legal or equitable interests of the debtor in property as of the commencement of the case."

17. In order to provide the debtor with enough of a stake to take advantage of the fresh start, an individual who is a debtor can retain or 'exempt' some property from the estate. Section 522 allows debtors to choose between a list of federal exemptions or to elect exemptions under state law.

of activities creditors could employ to collect pre-petition debts.<sup>18</sup> These activities specifically include foreclosures.

### C. Liquidation, Reorganization, Rehabilitation and Discharge

The Bankruptcy Code offers three different methods of protection for individual debtors. These are liquidation under Chapter 7, reorganization under Chapter 11 and debtor rehabilitation under Chapter 13.

Bankruptcies filed under Chapter 7 contemplate the liquidation of the bankruptcy estate.<sup>19</sup> This is known as "straight bankruptcy." The debtor in a Chapter 7 case takes the exemptions she can,<sup>20</sup> and the rest of her assets are collected by the Bankruptcy Trustee for distribution to creditors.<sup>21</sup> In return, the cooperative Chapter 7 debtor<sup>22</sup> receives a discharge of most pre-petition debts.<sup>23</sup> In essence, the discharge takes over where the automatic stay leaves off. Discharge voids any pre-petition judgment against the debtor, and acts as an injunction against efforts to collect pre-petition debts.<sup>24</sup>

While many individuals can take advantage of the rehabilitation provisions of Chapter 13,<sup>25</sup> it is not available to everyone. The Bankruptcy Code sets out four eligibility requirements: First, the debtor must be an individual—a person, as opposed to a business entity. Second, the debtor

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18. Section 362(a) provides that filing a petition stays all entities from beginning or continuing any judicial or administrative proceeding against the debtor to recover a pre-petition claim. Further, pre-petition judgments against the debtor or against property of the estate are stayed. Liens cannot be created or enforced. However, the scope of the stay is by no means limited to employment of legal process. Section 362(a)(3), for instance, prohibits "any act to obtain possession of property of the estate . . ."

The legislative history of § 362 highlights its importance:

The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collections efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy.

Senate Report No. 95-989 at 54-55.

19. Sections 701 *et seq.*

20. Section 522 sets up a dual system for exemptions. The debtor can choose between the Federally specified bankruptcy exemptions in § 522, or can utilize state-law exemptions to lien attachment. In addition, § 522 allows states to 'opt out' of the Federal exemptions by enacting statutes which mandate the use of state-law exemptions in bankruptcy.

21. Section 541.

22. Section 727 provides that an individual who has made a fraudulent transfer, or who disobeyed the court, cannot be granted a discharge.

23. Section 523 spells out debts which cannot be discharged. These include alimony, loans obtained by fraud, and student loans.

24. Sections 524(a) and 524(b) respectively. Sections 524(c) and 524(d) set strict limits on a creditor's means to seek post-petition reaffirmation of a pre-petition debt.

25. Sections 1301 *et seq.*

must have regular income. Third, the debtor's liquidated, non-contingent unsecured debts must total less than \$100,000. Finally, the debtor's total liquidated, non-contingent secured debts must total less than \$350,000.<sup>26</sup>

Chapter 13 rehabilitation presents significant advantages over liquidation for many people. A debtor under Chapter 13 retains possession of his property after filing.<sup>27</sup> Unlike other bankruptcies, automatic stay protection in Chapter 13 extends to codebtors such as co-signers or guarantors.<sup>28</sup> In addition, administration of a Chapter 13 case is generally simpler than reorganization under Chapter 11. This allows debtors to handle their case without high attorney's fees.

Chapter 13 is entitled "debt adjustment" because it reschedules payment of the debtor's obligations. In Chapter 13, future income is part of the estate,<sup>29</sup> and is used to pay past debts.<sup>30</sup> The debtor submits a plan for debt payment to the Bankruptcy Court for approval.<sup>31</sup> The plan of reorganization provides a schedule for paying all or a portion of the debtor's secured debt, and can provide for payment of unsecured debt as well.<sup>32</sup>

In return for this ease of administration, Chapter 13 imposes significant burdens on a debtor. Debts must usually be paid under the plan within three years.<sup>33</sup> Further, section 1325(a)(3) provides that the plan must be "proposed in good faith" to be confirmed. The reason for this requirement is that Chapter 11 creditors vote on the reorganization plan,<sup>34</sup> but Chapter 13 creditors do not vote on the Chapter 13 plan. A Chapter 13 debtor who completes payments under the plan receives a discharge similar to a Chapter 7 debtor.<sup>35</sup>

Chapter 11 reorganization<sup>36</sup> allows the financially sophisticated debtor to reorganize.<sup>37</sup> Reorganizing under Chapter 11 is considerably more

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26. These requirements are spelled out in § 109(e).

27. Section 1306(b) states, "Except as provided in a confirmed plan [of reorganization] or order confirming a plan, the debtor shall remain in possession of all property of the estate."

28. Section 1301(a).

29. Sec. 1306(a)(2) provides that the estate includes "earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted . . . whichever occurs first."

30. Section 1322(a) provides, "The plan shall—(1) provide for the submission of all or such portion of future earnings or other future income of the debtor . . . as is necessary for the execution of the plan."

31. Section 1321, a model of economical drafting, states, "The debtor shall file a plan."

32. Section 1322(b)(4).

33. Section 1322(e) allows the court to extend payment for up to five years for cause.

34. Section 1126.

35. Section 1328(a) provides, "As soon as practicable after completion by the debtor of all payments under the plan . . . the court shall grant the debtor a discharge of all debts provided for by the plan . . ."

36. Sections 1101 *et seq.*

37. Chapter 11 is oriented toward business debtors. It was only in 1991 that the Supreme Court upheld the right of individuals not in business to reorganize under Chapter 11. *Toibb v. Radloff*, 111 S. Ct. 2197, 2202 (1991).

complicated than under Chapter 13. As in Chapter 13, the debtor remains in possession of the estate property.<sup>38</sup> However, creditors have much more power under Chapter 11 than under Chapter 13. They can remove the debtor from possession in favor of a trustee in certain circumstances.<sup>39</sup> They must approve reorganization plans,<sup>40</sup> and may submit their own under certain circumstances.<sup>41</sup>

In return for pursuing the complicated and expensive path of Chapter 11, the debtor keeps its property and receives a discharge. Confirmation of a plan lets the debtor keep his property "free and clear of all claims and interests of creditors. . . ."<sup>42</sup> In addition, plan confirmation discharges all pre-petition debts, whether or not the creditor voted in favor of the plan.<sup>43</sup>

#### D. Treatment of Liens in Bankruptcy

In general, perfected pre-petition consensual liens—i.e. security interests—pass through bankruptcy unaffected. They remain enforceable *in rem* after the debtor's discharge.<sup>44</sup> However, there are a number of exceptions within the Bankruptcy Code which provide for avoidance of both consensual and court-imposed liens.

The debtor or her dependents<sup>45</sup> may avoid a judicial lien to the extent that it impairs her exemptions.<sup>46</sup> The federal exemption scheme allows debtors to exempt up to \$7,500 in homestead equity.<sup>47</sup> Consequently, if there is an assessment lien for \$1,500 against a homestead condominium, the lien impairs this exemption, and section 522 avoids the lien.<sup>48</sup>

38. Section 1107.

39. Section 1104(a) provides for removal of the debtor-in-possession for cause including fraud, gross mismanagement, or if appointment of a trustee "is in the interests of creditors, any equity security holders, and other interests of the estate. . . ."

40. Section 1126.

41. Section 1121(c) allows "any party in interest" to file a plan if the debtor is removed, does not file a plan within 120 days of the petition, or files a plan which is not approved within 180 days of the petition.

42. Section 1141(c).

43. Sections 1141(d)(1)(A) and 1141(d)(1)(A)(iii).

44. *Dewsnup v. Timm*, 112 S. Ct. 773, 778 (1992); *In re Stern*, 44 B.R. 15, 17 (Bankr. D. Mass. 1984); LAWRENCE KING, 3 COLLIER ON BANKRUPTCY ¶ 524.01[3] at 524-16 (15th ed. Supp. 1992). With regard to § 522(c), "The bankruptcy discharge does not prevent enforcement of valid liens." Senate Report 95-989 at 76.

45. Under § 522(l), a debtor's dependents may assert the debtor's exemptions if the debtor does not do so.

46. Section 522(f)(1). Under § 522(b), only individual debtors (as opposed to business debtors) are allowed exemptions.

47. Section 522(d)(1). Section 522(a) allows debtors to choose between the federal exemption scheme and state-law exemptions. Many states allow homestead exemptions well in excess of \$7,500.

48. Thus, where this Comment refers to "assessments," it is inconsequential whether they take the form of debts or of assessment liens.

Similarly, the debtor may avoid many non-purchase-money security interests to the extent that they impair an exemption.<sup>49</sup> Unperfected security interests are avoidable.<sup>50</sup> Any statutory lien is avoidable to the extent that it first became effective against the debtor after the petition was filed,<sup>51</sup> or when the debtor was insolvent.<sup>52</sup> The trustee<sup>53</sup> may avoid any transfer which is avoidable under state law.<sup>54</sup>

The Bankruptcy Code also provides for avoidance of preferential transfers, whether consensual or court-imposed. Under section 547(b), the trustee may avoid transfers made for the benefit of a creditor during the ninety days preceding bankruptcy.<sup>55</sup> This avoidance period extends to one year if the creditor was an insider.<sup>56</sup> Finally, fraudulent transfers made within one year pre-petition can be avoided.<sup>57</sup> Under appropriate circumstances, these powers to avoid could be applied to pre-petition condominium assessment payments.

## II. DISCHARGING POST-PETITION ASSESSMENTS IN CHAPTER 13

The leading case on dischargeability of post-petition condominium assessments<sup>58</sup> in Chapter 13 comes from the Northern District of Illinois. This opinion<sup>59</sup> holds that the statutory language of Chapter 13 dictates that these debts are non-dischargeable. It is particularly noteworthy because the

49. Section 522(f)(2) provides for avoidance to the extent an exemption is impaired by a non-purchase-money security interest concerning: (A) household furnishings and goods, clothing, musical instruments, etc., held for personal, family, or household usage; (B) tools of the debtor's trade, or that of her dependents; and (C) prescribed health aids.

50. Sections 544(a) and 545(2).

51. Section 545(1)(A). This also applies where a state-court receivership action is begun. Section 545(1)(B).

52. Section 545(1)(D).

53. Under § 1107(a), a Chapter 11 debtor-in-possession has the rights and powers of a Chapter 7 or Chapter 13 trustee.

54. Sections 544(a) and (b).

55. The transfer is avoidable to the extent that it allows the creditor to receive more than it would in a liquidation case. Section 547(b)(5). Further, § 547(c) provides for exceptions to avoidance which include the following: (1) Contemporaneous transfers for new value; (2) Payments in the ordinary course of business; (3) Enabling loans; (4) Transfers providing additional value as part of a previously made, non-avoidable agreement.

56. Section 547(b)(4)(B). Section 101(31) provides a comprehensive and lengthy definition of 'insider' which includes all directors, relatives, affiliates, or persons in control of the debtor. Senate report No. 95-989 adds, "An insider is one who has a sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arms length with the debtor."

57. Section 548(a)(2)(A) defines a fraudulent transfer to include any transaction for which the debtor received less than reasonable value. Actual intent to defraud is not required. Section 548(a)(2)(B) includes any transfer made while the debtor was insolvent.

58. As the foregoing material makes clear, condominium charges which are assessed pre-petition are dischargeable as pre-petition debts. See *supra* note 24 and accompanying text.

59. *In re Harvey*, 88 B.R. 860 (Bankr. N.D. Ill. 1988).



court took pains to distinguish Chapter 13 from Chapter 7; in that district, post-petition assessments are discharged in Chapter 7.<sup>60</sup>

In *re Harvey*, the debtor listed pre-petition assessment arrearages in her petition.<sup>61</sup> Her Chapter 13 plan provided for payment of these arrearages to the Association.<sup>62</sup> The Debtor continued to occupy the condominium during the case, and after her discharge.<sup>63</sup>

Generally, a discharge under Chapter 13 discharges debts "provided for" by the plan.<sup>64</sup> Use of the plan to cure a default in arrearages is "providing for" a debt within the meaning of this section.<sup>65</sup> However, the Chapter 13 discharge provision specifically exempts from discharge debts with payment schedules longer than that of the reorganization plan.<sup>66</sup> Clearly, a mortgage is one such debt: if the plan runs for three years<sup>67</sup> and the mortgage runs for fifteen, the mortgage is not discharged.

The *Harvey* court considered condominium assessments in light of these provisions. First, the court noted the Association had stated it only sought permission to foreclose for post-petition debts.<sup>68</sup> Additionally, the plan provided for arrearages in pre-petition assessments. Accordingly, the court reasoned, any debt sought by the association must be post-petition debt.<sup>69</sup> As such, the assessments were not discharged under section 1328(a)(1) and 524(a).<sup>70</sup>

*Harvey* spells out that Congress enacted specific language preventing the discharge of condominium assessments in Chapter 13. However, the provisions of section 1322(b)(5) only apply to Chapter 13 cases.<sup>71</sup> There is no analogous language which applies in a Chapter 7 or a Chapter 11 proceeding. This special statutory treatment allowed the *Harvey* court to deal concisely with the question of whether the assessment debt arose pre-petition

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60. A second Chapter 13 case on this topic is *In re Case*, 91 B.R. 102 (Bankr. D. Colo. 1988). This case comes from Colorado, a district which has consistently held against discharging condominium assessments. Because this opinion does not distinguish Chapter 13 from Chapter 7, it is discussed in the portion of this Comment concerning 'no-discharge' Chapter 7 cases.

61. 88 B.R. at 861-62.

62. *Id.* at 862-63.

63. *Id.* at 862.

64. Section 1328(a) states that "the court shall grant the debtor a discharge of all debts provided for by the plan." and then lists exceptions.

65. *Harvey*, 88 B.R. at 862.

66. Section 1328(a)(1) exempts from discharge debts "provided for under § 1322(b)(5)." Section 1322(b)(5), in turn, provides for "any secured claim on which the last payment is due after the date on which the final payment under the plan is due."

67. *See supra* note 33 and accompanying text.

68. *Harvey*, 88 B.R. at 862, n.1.

69. *Id.* at 862.

70. Section 524(a) provides for enforcement of the discharge provisions of §§ 1328, 727 and 1141.

71. Section 103(h) states, "Chapter 13 of this title applies only in a case under such chapter."

or post-petition. That question is central to treatment of condominium assessments in Chapter 7 and 11, and the courts are divided.

### III. DISCHARGING POST-PETITION ASSESSMENTS IN CHAPTER 7

If the present state of published case law is an accurate indication, the question of discharge of condominium assessment debts is most likely to arise in liquidation cases. All eleven opinions holding for discharge are in Chapter 7 cases, as are four of the nine opinions holding against discharge.<sup>72</sup>

#### A. Overview: "Typical" Discharge and Non-Discharge Cases

The cases holding against discharge come from a common mold; although there are differences and refinements, they reflect a similar approach to the issue. The typical no-discharge case holds, first, that a debt for assessments arises when it becomes due—i.e., post-petition.<sup>73</sup> Second, these cases hold the obligation to pay the assessments runs with the land, so that if the debtor is record title holder, he must pay—even if he does not occupy the property.<sup>74</sup> Third, as owner, the debtor takes the benefit of services provided by the Association, and must take the burden of paying assessments.<sup>75</sup>

The typical line of reasoning in the cases holding for discharge rebuts these points. First, the discharge cases hold that acceptance of the CC&R—a pre-petition event—gives rise to contingent liability for assessments.<sup>76</sup> The due date is merely the date when the contingent obligation matures. Because the Code discharges contingent pre-petition liabilities,<sup>77</sup> assessments and assessment liens should be discharged even if the assessments come due post-

72. The respective opinions are summarized in Appendix A.

73. See, e.g., *Raymond*, 129 B.R. 354, 363-64 (Bankr. S.D.N.Y. 1991); *Rosteck II*, 95 B.R. 558, 559 (Bankr. N.D. Ill. 1988); *In re Lenz*, 90 B.R. 458, 460 (Bankr. D. Colo. 1988); *Horton v. Beaumont Place Homeowners Ass'n (In re Horton)* 87 B.R. 650, 652 (Bankr. D. Colo. 1987); *Rink v. Timbers Homeowners Ass'n I, Inc. (In re Rink)*, 87 B.R. 653, 654 (Bankr. D. Colo. 1987).

74. See, e.g., *Raymond*, 129 B.R. at 363-64; *Rosteck II*, 95 B.R. at 559; *Lenz*, 90 B.R. at 460; *Horton*, 87 B.R. at 652. But see *Rink*, 87 B.R. at 654.

75. See, e.g., *Case*, 91 B.R. at 104; *Horton*, 87 B.R. at 652; *Alexandria Knolls Condominium Homes Council of Co-Owners v. Strelsky (In re Strelsky)*, 44 B.R. 178, 180 (Bankr. E.D. Va. 1985).

76. See, e.g., *In re Rosteck*, 899 F.2d 694, 696 (7th cir. 1990) [hereinafter *Rosteck III*]; *In re Wasp*, 137 B.R. 71, 72 (Bankr. M.D. Fla. 1992); *In re Miller*, 125 B.R. 441, 443 (Bankr. W.D. Pa. 1991); *Cohen*, 122 B.R. at 758; *In re Turner*, 101 B.R. 751, 754 (Bankr. D. Utah 1989); *In re Ryan*, 100 B.R. 411, 415 (N.D. Ill. 1989); *Elias v. Fireside Terrace Condominium Ass'n*, 98 B.R. 332 (N.D. Ill. 1989); *In re Montoya*, 95 B.R. 511, 513 (Bankr. S.D. Ohio 1988); *In re Rosteck*, 85 B.R. 73, 76 (Bankr. N.D. Ill. 1988) [hereinafter *Rosteck I*].

77. See §§ 727(b), 1141(d)(1)(A), and 1327(c). "[A] debtor [should] be discharged from all prepetition debts, 'no matter how remote or contingent.'" *Behrens v. Woodhaven Ass'n (In re Behrens)*, 87 B.R. 971, 974 (Bankr. N.D. Ill. 1988) (quoting *In re Baldwin-United Corp.*, 48 B.R. 901 (Bankr. S.D. Ohio 1985)).

petition.<sup>78</sup> Second, many—although not all—of the “discharge” opinions hold that the obligation to pay assessments is properly characterized as an executory contract, and may be rejected as such.<sup>79</sup> Third, the discharge courts note the only time a Chapter 7 debtor regains a condominium is when it has been abandoned by the estate due to lack of equity. Accordingly, where a debtor no longer occupies a no-equity condominium, any benefit the Association provides accrues to the mortgage holder—not to the debtor.<sup>80</sup>

The next sections highlight these positions, noting idiosyncracies and inconsistencies within and between them.

### *B. Assessment Debts: Covenant or Executory Contract*

The “no-discharge” cases assert the obligation to pay assessments is a covenant running with the land. As such, it remains with the title holder, and should not be discharged. In response, most discharge cases profess that, although the obligation to pay condominium assessments arises from the CC&R, it nevertheless is an executory contract rather than a covenant. The difference is crucial: Under section 365, the estate may reject any executory contract. In contrast, a covenant gives rise to a real property interest<sup>81</sup> which cannot be “rejected.”

This Comment draws on both approaches, while embracing neither. This section shows that the obligation to pay assessments arises from a covenant. However, the Comment goes on to consider the focal question concerning any debt in bankruptcy: Once the debt is classified, how should it be treated? A following section shows that the covenant gives rise to a contingent, unmatured, pre-petition liability. This liability is dischargeable.

#### 1. The Assessment Obligation as an Executory Contract

Almost all of the discharge cases are based, in part, on the proposition that the obligation to pay condominium assessments is an executory contract which the estate, or the debtor, may reject.<sup>82</sup>

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78. See, e.g., *Rosteck III*, 899 F.2d at 696; *Miller*, 125 B.R. at 443; *Cohen*, 122 B.R. at 758; *Turner*, 101 B.R. at 754; *Ryan*, 100 B.R. at 411; *Elias*, 98 B.R. at 337; *Montoya*, 95 B.R. at 513; *Behrens*, 87 B.R. at 971; *Rosteck I*, 85 B.R. at 76. In at least one case the court does not address the impact of exemptions on assessment liens. *In re Wasp* holds that, while personal liability is extinguished at discharge, *in rem* liability remains. *Wasp*, 137 B.R. at 72.

79. See, e.g., *Rosteck III*, 899 F.2d at 696; *Miller*, 125 B.R. at 443; *Ryan*, 100 B.R. at 415; *Behrens*, 87 B.R. at 975. See *Wasp*, 137 B.R. at 72.

80. See, e.g., *Miller*, 125 B.R. at 443; *Elias*, 98 B.R. at 337.

81. See generally 20 AM. JUR. 2D COVENANTS, CONDITIONS AND RESTRICTIONS § 38, at 608 (1991).

82. Sec. 365(a) allows the trustee to assume or reject any executory contracts or unexpired leases. Sec. 365(b)(1) provides that, if the contract is in default, the trustee must: (A) cure before assuming; (B) provide compensation for damages from default; and (C) provide assurance of future performance under the contract. Under § 365(g), the trustee’s timely rejection of an executory contract constitutes a breach of the contract “immediately before the date of the filing

Some of the cases simply state this as a matter of law. *Behrens v. Woodhaven Ass'n*<sup>83</sup> is one such case. The *Behrens* court states the debtors "claim that their obligation to pay the condominium assessments was an executory contract which was deemed rejected when not assumed within 60 days of the filing of the petition for relief."<sup>84</sup> The court notes the Association's position that the obligation becomes a lien when assessed because it is a covenant running with the land.<sup>85</sup> Thereafter, the court goes on to show that the Association cannot enforce the executory contract against the debtor—without providing any rationale for its position.<sup>86</sup> Having made this leap of faith, *Behrens* continues with a clear analysis of why the obligation should be discharged. However, the court never addresses the Association's point that the obligation is a covenant running with the land, rather than an executory contract.

One notable case addresses contractually-based arguments by both the Association and the debtor. In *re Wasp*, the court rejects the Association's contention that the debtors CC&R gave rise to a series of post-petition contracts for assessments, each coming due on the assessment date.<sup>87</sup> Nevertheless, the court held, without citations to authority, that "Debtors became contractually obligated to pay Association fees pre-petition."<sup>88</sup>

Other cases attempt to provide support for the obligation as an executory contract. For instance, *In re Rosteck* and *In re Ryan* each cite *Streams Sports Club Ltd. v. Richmond*<sup>89</sup> for the proposition that Illinois law views the obligation to pay condominium assessments as an executory contract.<sup>90</sup> However, this approach contains a crucial extension of *Streams* beyond its actual holding.

In *Streams*, the Illinois Supreme Court considered whether a recorded covenant to pay assessments for a condominium sports club ran with the land, or whether it was personal in nature.<sup>91</sup> The court held the provision in question was a valid covenant running with the land.<sup>92</sup> It also noted that nearly every jurisdiction considering the nature of CC&R had found they were covenants running with the land.<sup>93</sup>

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of the petition."

83. (*In re Behrens*), 87 B.R. 971 (Bankr. N.D. Ill. 1988), *aff'd*, 1989 WL 47409 (N.D. Ill. 1989), *appeal dismissed*, 900 F.2d 97 (7th Cir. 1990).

84. 87 B.R. at 974, citing § 365(d)(1).

85. *Id.*

86. *Id.* at 974-75.

87. *Wasp*, 137 B.R. at 72.

88. *Id.*

89. 457 N.E.2d 1226 (Ill. 1983).

90. *Rosteck*, 899 F.2d at 696; *Ryan*, 100 B.R. at 415.

91. *Streams*, 457 N.E.2d at 1230.

92. *Id.* at 1230-31.

93. *Id.* at 1231, citing cases.

The court then considered the tenant's contention that "*the contract* was unconscionable, vague and lacking in mutuality."<sup>94</sup> The court held that it was not.<sup>95</sup> However, since the assessment lien was enforceable as a covenant, the *Streams* court declined to reach whether the lien was enforceable as a third-party beneficiary contract.<sup>96</sup> Thus, the *Streams* court straddled an analytical razor's edge. On the one hand, it found that the covenant was not unenforceable as a vague, unconscionable contract. On the other, *Streams* does not reach whether the covenant was affirmatively enforceable as a contract.

Consequently, *Streams* represents a weak foundation for the *Ryan* and *Rosteck III* courts. *Streams* holds only in the negative: The covenant in question was not a voidable contract. *Rosteck III* and *Ryan* convert that holding into the affirmative proposition that valid real property covenants are executory contracts which can be rejected under the Bankruptcy Code.<sup>97</sup>

The contractual approach to condominium assessment analysis has a more fundamental flaw. A covenant-based obligation to pay assessments, by definition, will never be enforceable as an executed contract.<sup>98</sup> Since both the Association and the homeowner have on-going obligations to perform, the relationship is intended to remain executory. The Association must continuously provide services, as the homeowner must continuously pay for them. The purpose of CC&R is to set forth perpetual duties—the antithesis of an executed contract. This shows that parties to a covenant do not intend to enforce the obligation as an executed contract. The obligation can only be enforced as a covenant running with the land.

## 2. The Assessment Obligation as a Covenant

A recent New York bankruptcy opinion lays out a more logical view on the covenant/contract question.<sup>99</sup> This case holds the obligation to pay assessments is a covenant running with the land, rather than an executory contract.

*In re Raymond* subjects the obligation to pay condominium assessments to a lengthy analysis under the leading case, *Neponsit Property Owners' Ass'n v. Emigrant Industrial Savings Bank*.<sup>100</sup> Prior to *Neponsit*, New

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94. *Id.* at 1232 (emphasis added).

95. *Id.*

96. *Id.* The homeowner, a tenant, asserted that the contract was between the club and the owners of the condominium. *Id.* at 1231.

97. *Rosteck III*, 899 F.2d at 696; *Ryan*, 100 B.R. at 415.

98. "An executory contract is one in which a party binds himself to do or not to do a particular thing, whereas an executed contract is one in which the object of the agreement is performed and everything that was to be done is done." 17A AM. JUR. 2D CONTRACTS § 6, at 30 (1991).

99. *Raymond*, 129 B.R. at 354.

100. 278 N.Y. 248, 15 N.E.2d 793, *reh'g denied*, 278 N.Y. 704, 16 N.E.2d 852 (1938).

York law held that only negative obligations run with the land.<sup>101</sup> *Neponsit* created an exception for a covenant to pay money for maintenance of common areas where the obligation 'touches and concerns' the land.<sup>102</sup> The *Raymond* court concludes:

The Debtors' obligation to pay common charges . . . satisfies each prong of the three-part [*Neponsit*] test for a covenant running with the land. It is an obligation which not only binds them, but would have bound their assigns and grantees. It is inseparably connected to the ownership of the condominium unit.

Accordingly, the court found that the obligation is a covenant.<sup>103</sup>

There are other reasons why the assessment obligation is better treated as a covenant than as an executory contract. First, the obligation to pay assessments is not subject to conditions, which would be applicable if the obligation were a contract.<sup>104</sup> Condominium owners have a duty to pay assessments even if the Association neglects to provide certain services. If an assessment obligation was a contract, condominium owners would not be obligated to pay their assessments if the Association failed to cut their lawn, for example.

Secondly, as *Streams* demonstrates, approaching the assessment obligation as a covenant running with the land avoids potentially clumsy or ineffective third-party-beneficiary analysis. If the assessment obligation is a contract, then one who acquires a condominium by a pure gift is not a party to the contract. Consequently, such an owner would have no express obligation to pay assessments.<sup>105</sup>

The position that the assessment obligation is a covenant has the assent of each of the non-discharge cases cited in this Comment. It is the valid analytical approach. However, significant difficulties arise when courts attempt to bootstrap this analysis to the conclusion that a debt arising from a covenant cannot be discharged in bankruptcy.

### *C. Horton's Novel, But Flawed, Semantic Analysis*

One often-cited case holding against discharge is *In re Horton*.<sup>106</sup> The *Horton* court, in an effort to show that an assessment debt arises post-petition, based its position on the semantics of the Bankruptcy Code.

101. See 278 N.Y. at 256-57, 15 N.E.2d at 795-76.

102. *Id.*; 278 N.Y. at 255-58, 15 N.E.2d at 795-97; *Raymond*, 129 B.R. at 362.

103. *Raymond*, 129 B.R. at 363.

104. See generally 17A AM. JUR. 2D CONTRACTS § 465.

105. But see 17A AM. JUR. 2D CONTRACTS § 459 (sparse authority for the proposition that a third-party beneficiary to a contract must take the burden of the contract, as well as the benefit).

106. 87 B.R. 650.

Essentially, *Horton* attempts to conclude that section 524 discharges the assessment debt but not the debtor's personal liability for the debt.<sup>107</sup>

The court made much of section 524's legislative history. Senate Report No. 95-989 states that section 524(a) "specifies that a discharge . . . voids any judgment to the extent that it [determines] the personal liability of the debtor with respect to a *pre-petition* debt. . . ." <sup>108</sup> Without reference to any case law, *Horton* proclaims that section 524 discharges a pre-petition debt<sup>109</sup> but not the *liability* for the debt.<sup>110</sup> Were this the case, personal liability for an assessment debt would survive discharge, even though the debt itself is discharged.<sup>111</sup>

*In re Elias*<sup>112</sup> highlights the flaws in *Horton*'s attempt to distinguish "debt" from "liability" under the Code. First, the *Elias* court notes the cited Committee Report language is not in point; it does not address how to determine what is a pre-petition debt.<sup>113</sup> More importantly, *Elias* discusses how the Code associates the words "liability" and "debt" in a fashion which is inconsistent with *Horton*'s reading.

The Code defines "debt" as "liability on a claim."<sup>114</sup> A "claim," in turn, means a "right to payment, whether or not such right is . . . contingent . . ."<sup>115</sup> In drafting the Code, Congress intended the definition of claim to be broad, rather than limited.<sup>116</sup> In fact, the same Committee report cited by the *Horton* court states elsewhere, "The terms 'debt' and 'claim' are co-extensive. That is, a creditor has a 'claim' against the debtor and the debtor owes a 'debt' to the creditor."<sup>117</sup> This language hardly shows Congressional intent to distinguish the meanings of "debt" and "liability." *Elias* points out:

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107. *Id.* at 652.

108. *Id.* at 652 (quoting S. Rep. 95-989 at 80 (emphasis in *Horton*)).

109. Section 524(a)(1) provides that a discharge voids any judgment at whenever obtained, to the extent that it is a determination of the debtor's personal liability with respect to any debt discharged under sections 727, 1141, or 1328.

Section 524(a)(2) provides that discharge acts "as an injunction against the commencement . . . of an action . . . or an[y] act to collect . . . any such [discharged] debt as a personal liability of the debtor. . . ."

110. *Horton*, 87 B.R. at 652.

111. *Id.* Contrast *Dewsnup v. Timm*, wherein the Supreme Court held that *in rem* liability remains notwithstanding discharge of personal liability. 112 S. Ct. at 778. *Dewsnup* cites, *inter alia*, *Johnson v. Home State Bank*, 111 S. Ct. 2150, 2154 (1991): "[A] bankruptcy discharge extinguishes only one mode of enforcing a claim—namely, an action against the debtor *in personam*—while leaving intact another—namely, an action against the debtor *in rem*."

112. 98 B.R. 332 (N.D. Ill. 1989).

113. *Elias* at 335.

114. Section 101(12).

115. Section 101(5).

116. *Elias*, 98 B.R. at 332 (citing *Ohio v. Kovacs*, 469 U.S. 274 (1985)).

117. S. Rep. No. 989, quoted in *Elias*, 98 B.R. at 333-34.

What the [distinction] held, in effect, is that only claims accrued pre-petition are debts under the Code . . . . [T]his interpretation is at loggerheads with the statute's wording. After all, the definition of a 'claim' includes *contingent* rights to payment. And *Horton* has effectively read this language out of the statute.<sup>118</sup>

Accordingly, this language provides a weak foundation for determining that an assessment debt arises post-petition. There is much stronger support for the opposite position—that the obligation to pay assessments is a pre-petition debt.

#### D. *The Obligation to Pay Assessments Arises Pre-Petition*

The determination of whether the obligation to pay assessments creates a dischargeable, pre-petition debt does not hinge on whether a "debt" is a "liability" under the Code. It does not hinge on whether the obligation is a covenant or a contract. The central question for these types of debts is not how they arise, but rather, when they arise. The proper analysis lies in giving the covenant debt the treatment which all debts receive in bankruptcy; examining when the debt arose to determine whether it is dischargeable under the Code. That is the approach the discharge cases employ.<sup>119</sup>

Indeed, at least one court discharged an assessment debt without ever addressing the covenant/contract question. In *re Cohen*,<sup>120</sup> the court notes the debt arose from the CC&R. However, alone among the cases on this question, *Cohen* disposes of the controversy before it without even making reference to covenant or contract as the basis for the assessment. In this manner, the *Cohen* court neatly sidesteps the pitfalls of treating a covenant as a contract. Rather, the *Cohen* court "observe[s] that the central question to be resolved [is] when the debt arose."<sup>121</sup>

The concept of discharging contingent liability is central to the cases which hold for discharge. These cases hold that acceptance of the CC&R creates a contingent liability for assessments.<sup>122</sup> Under this view, the date the assessment is levied is merely the date when the contingent liability matures.<sup>123</sup> Since the debtor bought the condominium and accepted the CC&R pre-petition, the assessment debts are dischargeable as pre-petition debts.

118. *Elias* at 335 (emphasis in original). *Accord, Rosteck I*, 85 B.R. at 76.

119. The most recent published decision on this question states the matter bluntly. In a Chapter 7 context, "This Court's decision turns on when Debtors' debt to the Association arose, not on whether Debtors had vacated the premises pre-petition, whether the property was the subject of a foreclosure action pre-petition, or whether Debtors were receiving any benefits of ownership post-petition." *In re Wasp*, 137 B.R. at 72.

120. 122 B.R. 755.

121. *Cohen*, 122 B.R. at 758, citing *Rosteck II*, 899 F.2d at 696.

122. *See, e.g., Cohen* at 758; *Behrens*, 87 B.R. 971 at 975; *Rosteck III* at 696-97.

123. *See supra* notes 78 and 79 and accompanying text.



There are two important policy considerations which make this rule sensible. First, while state law controls the property rights the debtor brings into bankruptcy,<sup>124</sup> federal bankruptcy law controls in the determination of dischargeability.<sup>125</sup> "The question of what is a 'debt' for purposes of the Bankruptcy Code and dischargeability is a question of bankruptcy law not state law."<sup>126</sup> This doctrine subjects the *Horton* court, and those which follow it, to criticism for giving state-law theories of title undue weight in determining dischargeability.

Second, and most importantly, a holding that retention of title automatically exposes the debtor to renewed liability for assessment debts "effectively gut[s] the careful protections Congress afforded individual debtors against unknowing, inadvertent or involuntary reaffirmations in . . . sections 524(c)<sup>127</sup>(d)."<sup>128</sup> As the Seventh Circuit Court of Appeals pointed out in *Rosteck III*:

[The Association]'s argument appears to be that because there was no money actually due, there was no debt. In other words, [the Association] in essence argues that a liability must be fixed and liquidated before it is a debt, an argument at odds with the Bankruptcy Code's definition of "debt."<sup>129</sup>

Well-established analogies support the *Rosteck III* court in taking this position. For example, one recent case holds that an escape tax on real property, assessed post-petition, related back to a pre-petition tax claim.<sup>130</sup>

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124. *Butner v. United States*, 440 U.S. 48, 56 (1979).

125. See *Ryan*, 100 B.R. at 414-15; *Behrens*, 87 B.R. at 975.

126. *Behrens*, 87 B.R. at 975 (citing *In re Edge*, 60 B.R. 690 (Bankr. M.D. Tenn. 1986)); accord, *Turner*, 101 B.R. at 754. However, "[w]hile federal law controls which claims are cognizable under the Code, the threshold question of when a right to payment arises, absent overriding federal law, is to be determined by reference to state law." *Avellino & Bienes v. M. Frenville Co., Inc. (In re M. Frenville Co., Inc.)*, 744 F.2d 332 (3d Cir. 1984), cert. denied, 469 U.S. 1160 (1985)(quotes omitted)(collecting cases).

127. Section 524(c) spells out that a debtor can reaffirm a dischargeable pre-petition debt only under severely limited conditions, including the following: (1) The reaffirmation agreement was made before discharge; (2) The agreement clearly informs the debtor that it may be rescinded within a certain period; and (3) The agreement is accompanied by a statement from counsel that the debtor was advised of its consequences, and that the debt is not an undue hardship on the debtor.

128. Section 524(d) requires the court to hold a hearing to inform individual debtors that reaffirmation is not required by bankruptcy or other law, and of the consequences of reaffirmation. Further, if the underlying debt is not a consumer debt secured by real property, the court must determine that reaffirmation does not unduly burden the debtor. *Behrens*, 87 B.R. at 975.

129. *Rosteck III*, 899 F.2d at 697 n.3.

130. *In re Grivas*, 123 B.R. 876, 880-81 (S.D. Cal. 1991).

*E. Benefit & Burden: The Debtor's 'Choice' to Retain the Condominium*

Many of the no-discharge opinions assert the debtor, as record owner of the property, reaps the benefit of services the Association provides post-petition.<sup>131</sup> These cases generally state the debtor chooses to remain record owner, and thus cannot escape liability for assessments.<sup>132</sup> However, the discharge cases rebut both points.

Once a Chapter 7 petition is filed, the condominium becomes part of the estate.<sup>133</sup> If there is any equity in the property after exemptions,<sup>134</sup> the bankruptcy trustee must sell the property.<sup>135</sup> If there is no equity, the estate may abandon the property back to the debtor.<sup>136</sup> At that point, if the debtor has pre-petition arrearages, the property is ripe for foreclosure. If there are no arrearages, the debtor may enter into a reaffirmation agreement with the lender.

This scenario leads to two conclusions. First, the debtor really does not have a choice about whether to remain on no-equity real property; rather, the choice belongs to the lien-holder. The lien-holder can foreclose<sup>137</sup> nearly at will,<sup>138</sup> or choose to accept a deed in lieu of foreclosure if the debtor proffers one.<sup>139</sup>

Secondly, there is no reason to conclude that any significant benefit provided by the Association for no-equity property accrues to the debtor. One may argue that, because Association services maintain the value of the property, the debtor's potential deficiency is minimized. However, this is indirect at best. Many states restrict or deny deficiency judgments on homesteads.<sup>140</sup> In truth, the benefit inures to the Association,<sup>141</sup> and to

131. See *supra* note 75 and accompanying text.

132. See, e.g., *Strelsky*, 46 B.R. at 180; *Case*, 91 B.R. at 104 (Chapter 13). *Case* notes that Colorado law gives the debtors a right to redeem even after the foreclosure. "If debtors desired to end the continuing obligation to pay assessments, then they needed only to divest themselves of ownership by deeding the property to the lender. However, these debtors elected not to do so."

133. Section 541(a)(1) states the filing of the petition creates an estate consisting of "all legal or equitable interests of the debtor in property as of the commencement of the case." This transfer takes place without any impact on recorded title.

134. See *supra* note 47 and accompanying text.

135. Section 704 provides, "The trustee shall—(1) collect and reduce to money the property of the estate . . ."

136. Section 554 allows the trustee to "abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate."

137. The lienholder will need to comply with state law foreclosure statutes. The lienholder will also need to obtain relief from the automatic stay. Section 362(d)(2) provides that, in a liquidation case, lack of equity is grounds for lifting the stay.

138. *Elias*, 98 B.R. at 336-37; *Cohen*, 122 B.R. at 758; *Rosteck III*, 899 F.2d at 697.

139. See 5 DON AUGUSTINE & STANTON H. ZARROW, CALIFORNIA REAL ESTATE LAW & PRACTICE § 120.25[1], at 120-29 (1991).

140. See, e.g., CAL. CIV. PROC. CODE § 580b (West 1976).

the mortgage holder.<sup>142</sup> This is particularly true if a debtor abandons the property to the lender. In that case, possession is relinquished, and the debtor should not be liable for future assessments.<sup>143</sup>

*F. The Lienholder Has Adequate Remedies in This Situation*

The no-discharge cases also assert a public policy favoring no discharge. Indeed, some discharge cases express qualms with the result. Many of the courts holding for discharge have recognized that discharging condominium assessment liens (where there is no *in rem* liability) apparently lets debtors "off the hook" by enabling them to reside in their homes unencumbered by assessments, no matter how long after the discharge.<sup>144</sup> This apparently gives the debtor a "head start," rather than a "fresh start."<sup>145</sup> The Seventh Circuit Court of Appeals, in taking note of this apparent advantage, nevertheless turned the responsibility back toward Congress:

While this problem is admittedly troubling, we think the broad language Congress used in the Bankruptcy Code compels the result we reach. We have no power to change that language to reach a more palatable result. Contingent debts are still debts, and Congress has not exempted the type of debt in this case from discharge.<sup>146</sup>

This line of reasoning is underscored in that Congress specifically undertook to exempt long-term debts from discharge under Chapter 13.<sup>147</sup> Congress could easily have provided exceptions in Chapter 7 like those in Chapter 13, but apparently chose not to.<sup>148</sup>

However, all of these cases point out the debtor's assessment-free tenancy is likely to be brief. As noted above, the lienholder (including a condominium association) can foreclose on no-equity property with relative ease.<sup>149</sup> In addition, the Association has other remedies available to it which insure that debtors do not avoid assessments for a lengthy period.<sup>150</sup>

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141. The typical condominium deed and CC&R provide that the Association has an interest in any external surface of the building, any load-carrying walls, and much or all of the land around the building.

142. *Miller*, 125 B.R. at 443.

143. *Miller* 125 B.R. at 443; *Ryan*, 100 B.R. at 416. *Turner* provides an extreme example of the mortgagee's power to force a debtor into keeping no-equity property: the mortgagee would not accept the debtor's proffered deed in lieu of foreclosure. *Turner*, 101 B.R. at 754.

144. *Rosteck III*, 899 F.2d at 697; *Elias*, 98 B.R. at 336.

145. *Id.*

146. *Rosteck III*, 899 F.2d at 697, following *Elias*, 98 B.R. at 336.

147. See *supra* note 64 and accompanying text.

148. *Elias*, 98 B.R. at 335.

149. The lienholder must obtain relief from stay. See *supra* note 18 and accompanying text.

150. *Cohen*, 122 B.R. at 758.

First, if there is equity in the property, the Association may seek to have the trustee reaffirm the obligation on behalf of the estate.<sup>151</sup> If the debt is reaffirmed by the trustee, assessments during the period between the filing of the petition and discharge are given administrative priority.<sup>152</sup>

Second, if there is no equity and the trustee abandons the property back to the debtor, the Association may seek to have the debtor voluntarily reaffirm the debt in accordance with the strict standards of section 524(c).<sup>153</sup> As noted above, if there is *in rem* liability, the Association can foreclose.<sup>154</sup> Finally, if the Association provides services which are "monopolistic" in nature, such as electricity, some courts have allowed the Association to seek adequate assurance of payment<sup>155</sup> per section 366(b).<sup>156</sup>

In sum, assessments should be dischargeable in Chapter 7. However, even if the debtor refuses to surrender the property to the mortgagee voluntarily, her "assessment-free" stay in the property will be brief.

#### IV. CONDOMINIUM LIENS IN CHAPTER 11: TOWARD 'PAY TO STAY'

To date, only one opinion has considered the question of discharging condominium assessment liens in a Chapter 11 reorganization context.<sup>157</sup> However, this Colorado case applies the *Horton* treatment criticized above, and does not offer any special insight into how the question differs in Chapter 11. Accordingly, this Comment considers how to modify the Chapter 7 approaches noted above for application under Chapter 11.

Chapter 11 differs from Chapter 13, in that the special statutory treatment which Chapter 13 affords continuing obligations is not present under Chapter 11.<sup>158</sup> Chapter 11 reorganization also displays important differences from liquidation under Chapter 7. Under Chapter 11, the debtor-in-possession retains possession and control of estate property during and after the bankruptcy case.<sup>159</sup> Thus, a successful reorganization raises the likelihood of a lengthy "assessment-free" stay by the debtor if the Chapter

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151. Section 524(c); *see supra* note 24 and accompanying text.

152. Section 503(b)(1)(A) gives first priority in bankruptcy (excluding voluntary, non-avoidable secured loans) to "the actual, necessary costs and expenses of preserving the estate. . ."

153. *See supra* note 24 and accompanying text.

154. *See supra* note 9 and accompanying text.

155. *Hobbs v. Summit House Condominiums*, 20 B.R. 488, 489 (Bankr. E.D. Pa. 1982); *Cohen*, 122 B.R. at 758 (dicta).

156. Section 366(b) allows utilities to discontinue service if the debtor or trustee in arrears does not provide adequate assurance of payment within 20 days of the petition date.

157. *Lenz*, 90 B.R. at 458.

158. *See supra* note 64 and accompanying text.

159. Section 1107(a) provides the Chapter 11 debtor in possession "shall have all the right . . . and powers, and shall perform all the functions and duties . . . of a trustee . . ." These include the gathering and retaining of the estate under §§ 541 *et seq.*

7 analysis outlined above is applied without modification. The tension between these two positions must be reconciled to avoid a wholesale abrogation of assessment obligations under Chapter 11.

As the discussion below highlights, there is valid case law to allow the debtor to abandon the condominium without incurring liability for assessments. The unanswered question is this: How, within the framework of Chapter 11, can the Association make the debtor 'pay to stay?'

#### A. *The Montoya Approach: The Statement of Intention Controls*

One Chapter 7 case offers a framework for addressing assessments where the debtor's bankruptcy schedules show that he intends to vacate the property. In *re Montoya*,<sup>160</sup> the court allowed the Chapter 7 debtor to remain on the property temporarily where his petition stated his intention to surrender.

The court first contrasted the *Rosteck I* discharge approach with the no-discharge positions of *Harvey*, *Stern* and *Case*.<sup>161</sup> In particular, the court noted *Case*'s holding that, as a covenant running with the land, the obligation to pay assessments could not be rejected as an executory contract.<sup>162</sup>

The *Montoya* court made a conscious effort to synthesize the two disparate lines of authority. *Montoya* focuses on possession as the key to liability for assessments. Although the debtor still retained her statutory right of redemption, the Statement of Intention filed with her bankruptcy petition showed her decision to surrender the unit.<sup>163</sup> Under those circumstances, Judge Sellers wrote, the court was

compel[led] . . . to find that fees assessable against a debtor pursuant to a declaration of condominium ownership . . . may be discharged as an unmatured claim where the debtor abandons the condominium and all rights associated with such ownership before or upon the bankruptcy filing. The debtor may "walk away" from personal liability for such future assessments [upon discharge] . . . if the condominium association were properly scheduled as a creditor.<sup>164</sup>

*Montoya* presents a rational approach for several reasons. First, it recognizes the supremacy of federal bankruptcy law over state real property

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160. 95 B.R. at 511.

161. *Montoya*, 95 B.R. at 513.

162. *Id.*, citing *Case*, 91 B.R. 102.

163. Section 521(2) provides that if the debtor has consumer debts secured by real property, she must file a statement within 30 days after the petition showing her intent to retain or surrender the property, and her intent to claim exemptions. Under § 521(1)(B), the stated actions must be performed within 45 days of the filing of the statement of intent. Section 101(8) defines "consumer debt" as a "debt incurred by an individual for a personal, family, or household purpose."

164. *Montoya*, 95 B.R. at 513 (emphasis added).

law in determining what debts are dischargeable in bankruptcy.<sup>165</sup> Second, it reaches past the formalities of the debtor's abstract property rights to address the debtor's stated intent not to exercise those rights.

*Montoya* balances the fresh start in bankruptcy against the debtor's right to redeem. The opinion infers that the right to redeem is theoretically legitimate, but practically inconsequential, if the debtor promises not to exercise it.<sup>166</sup> When the debtor uses a bankruptcy petition to tell the world (including her creditors) that she is leaving the condominium, that is enough: the personal debt should be discharged, leaving the association with recourse solely against the property itself.

### *B. Ryan: Any Offer to Relinquish Possession is Sufficient*

A similar result was reached in *In re Ryan*.<sup>167</sup> The *Ryan* court adopted the "covenant as executory contract" approach criticized above,<sup>168</sup> and found that a condominium agreement is a contract which can be rejected using executory contract analysis.<sup>169</sup> While this analysis is suspect, it does not ultimately undermine the court's holding the obligation dischargeable as a pre-petition debt.<sup>170</sup>

Accordingly, the court found the debtor should not be liable for post-petition assessments regardless of where the offer to vacate is made.

If the debtor retains possession of the unit and/or asserts an ownership interest in the property, the condominium declaration has not been rejected. If, on the other hand, the debtor surrenders possession and tenders the ownership interest to the association before or upon filing a petition . . . the executory declaration is rejected and the obligation to pay postpetition assessments may be discharged.<sup>171</sup>

The court goes on to pronounce its position "a fair accommodation of the right and needs of the association [which] accomplish[es] the broad goals of the Bankruptcy Code."<sup>172</sup> In order to discharge assessment debts, the debtor must schedule the contingent, unmatured debt on his petition. The debtor must also relinquish possession within a reasonable time. Filing a bankruptcy petition, alone, is not sufficient.<sup>173</sup> This approach is consistent

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165. As shown in *supra* note 124, under *Butner* state law controls what property rights the debtor brings into bankruptcy. Bankruptcy law controls the disposition of the estate, including discharge.

166. See *Montoya*, 95 B.R. at 513.

167. 100 B.R. 411.

168. See *supra* note 82 and accompanying text.

169. *Ryan*, 100 B.R. at 415.

170. See *supra* note 119 and accompanying text.

171. *Ryan*, 100 B.R. at 416.

172. *Id.*

173. *Id.*

with the *Harvey* approach to Chapter 13. It is also similar to the framework employed when a trustee rejects a lease under section 365, but the debtor remains in possession of the unit.<sup>174</sup> Finally, it is also compatible with case law holding a Chapter 7 debtor who remains on her property may be liable to the estate for rent.<sup>175</sup>

*Ryan* highlights the unfairness inherent in the no-discharge approach taken by *Horton* and similar cases. The *Horton* approach, which holds record title alone controls liability for assessments, leaves the debtor wholly at the mercy of the Association. Under *Horton*, the debtor is liable until he or she is relieved of title.<sup>176</sup> If the debtor's offer of the property is refused, or if the Association is able to foreclose but does not, the debtor remains liable.<sup>177</sup> This approach encourages the Association to postpone foreclosing on its lien, in order to allow the charges to accrue. This approach plainly thwarts the essence of the Bankruptcy Code's "fresh start" policy.<sup>178</sup>

Taken together, *Ryan* and *Montoya* present a functional approach which transfers well from liquidation cases to Chapter 11 reorganizations. Whether a debtor files under Chapter 7 or Chapter 11, he or she should not be allowed a lengthy stay free of assessment charges. On the other hand, the purpose of bankruptcy is to relieve the debtor from creditor pressure. This policy is circumvented when the Association can single-handedly control the debtor's ability to surrender property and unilaterally increase its own debt.

*Montoya* and *Ryan* present a valid approach to the issue of exonerating a debtor who intends to vacate the condominium. But what of the related problem, that of enforcing the assessment where the debtor intends to stay?

### C. Enforcing Assessments Where the Debtor Does Not Vacate

At present, there is no mechanism within the Bankruptcy Code that explicitly enables an Association to enforce the obligation to pay assessments against a Chapter 11 debtor who elects to stay in possession of the property. The problem is this: One cannot discharge assessments as pre-petition debt, and still enforce assessment debts where the debtor remains on the property. Reaffirming the mortgage debt, in and of itself, does not vitiate the discharge of the assessment obligation.

The first answer to this dilemma is as practical as it is plain. Mortgage lenders can refuse to enter into a reaffirmation agreement with the debtor

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174. *Id.*

175. In *Spence v. Ament (In re Ament)*, the debtor stayed on the property for nine and a half months after filing her petition. The court held the debtor should pay rent for the months after the property was listed with a realtor. *In re Ament*, 77 B.R. 439, 440 (Bankr. D. Del. 1987).

176. *Horton*, 87 B.R. at 652.

177. *Id.*

178. *Ryan*, 100 B.R. at 416.

which does not provide for reaffirmation of the assessment obligation.<sup>179</sup> Under section 524(c)(3)(B), the parties can include any conditions in the reaffirmation agreement which do not present undue hardship.<sup>180</sup> However, this solution is less than ideal. The mortgage lender's first obligation will be to his loan; he has no duty toward the Association to provide for its needs. There may be circumstances under which a mortgage lender would agree to a reaffirmation of its loan without providing for the Association.

Second, the Bankruptcy Court's broad equity powers may allow it to ensure that any condominium mortgage reaffirmation agreement before it provides for reaffirmation of assessment debts. These equity powers have two statutory sources. The first is section 105(a), the general 'catch-all' equity grant to the Bankruptcy Court.<sup>181</sup> The second is section 1129(a)(3), which allows the court to reject a Chapter 11 plan that is not proposed in good faith. In making this determination, courts can make the analogy between the obligation to pay assessments and the obligations of a debtor-in-possession who reaffirms a lease under section 365.<sup>182</sup>

However, there can be no doubt that these solutions are inferior resolutions of this issue when compared to the clarifying effect of statutory language. Congress should make a clear statement that covenants to pay condominium assessments remain in force when a Chapter 11 debtor remains on the property. Section 365, which addresses executory contracts and leases, is a fitting location for such a statement.

#### CONCLUSION

Under the Bankruptcy Code, it is irrelevant whether the obligation to pay condominium assessments is viewed as arising from an executory contract, or from covenants that run with the land. The crucial question is: 'When do they arise?' The answer is the debtor's acceptance of the CC&R creates a contingent, unmatured liability. That this liability matures after the petition does not make it a post-petition debt. Thus, the obligation should be dischargeable in most Chapter 7 cases.

In contrast, the language of section 1322(b)(5) makes it clear Congress did not intend to discharge post-petition condominium assessments under Chapter 13.

In Chapter 11, the rule is less cut-and-dry. A debtor who remains on the property beyond a reasonable time after the petition should be liable for

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179. Indeed, mortgages and deeds of trust often include a requirement that the mortgagor remain current on assessments. See 4 HARRY D. MILLER & MARVIN B. STARR, CALIFORNIA REAL ESTATE § 9:54 (2d ed. 1989).

180. As noted, § 524 specifies that other requirements must be met before the court will approve a reaffirmation agreement. See *supra* note 24 and accompanying text.

181. Section 105(a) provides, "The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."

182. Section 365(b)(1)(C) allows a landlord to seek adequate assurance that a lease assumed in bankruptcy will be performed under the original lease contract.



assessments for the period beginning with the petition. The Code contains mechanisms to enforce condominium assessment obligations against debtors who remains on the property after the petition. However, these tools are inferior to a clear Congressional statement that assessment covenants should remain in force if the debtor retains the property.

If the debtor properly schedules the Association as a contingent, unmatured creditor, and if the debtor tenders the property, Chapter 11 properly relieves the debtor of post-petition assessment liability even if the Association rejects the tender. This rule is entirely in keeping with both the spirit and letter of the Bankruptcy Code.

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## APPENDIX A

## CONDOMINIUM ASSESSMENT CASES SUMMARIZED

<i>Case Name</i>		<i>Chapter</i>	<i>Authority</i>
<i>Discharge Cases</i>			
<i>Behrens Bk N.D. Ill. 1988</i>	7		<i>Rosteck I, Statute</i>
<i>Cohen Bk S.D. Cal. 1991</i>	7		<i>Rosteck III, Behrens</i>
<i>Elias Bk N.D. Ill. 1989</i>	7		<i>Behrens, Rosteck I; approves Harvey for Ch. 13</i>
<i>Miller Bk W.D. Pa. 1991</i>	7		<i>Rosteck III, Elias, Turner</i>
<i>Montoya Bk S.D. Ohio 1988</i>	7		<i>Rosteck I</i>
<i>Rosteck I Bk N.D. Ill. 1988</i>	7		Statute, Collier's
<i>Rosteck III N.D. Ill. 1989</i>	7		<i>Behrens</i>
<i>Rosteck III 7th Cir. 1990</i>	7		Statute, <i>Elias, Streams (Ill.)</i>
<i>Ryan Bk N.D. Ill. 1989</i>	7		<i>Behrens, Elias</i>
<i>Turner Bk D. Utah 1989</i>	7		Statute, <i>Behrens, Elias</i> etc.
<i>Wasp, Bk M.D. Fla. 1992</i>	7		<i>Rosteck, Elias, Cohen, Behrens</i>
<u>No Discharge Cases</u>			
<i>Case Bk D. Col. 1988</i>	13		Colorado Condo Statute
<i>Harvey Bk N.D. Ill. 1988</i>	13		§ 1328, Collier's
<i>Horton Bk D. Col. 1987</i>	7		Statute, <i>Strelsky</i>
<i>Lenz Bk D. Col. 1988</i>	11		<i>Horton, Gile, Rink</i>
<i>Raymond Bk S.D.N.Y. 1991</i>	7		<i>Behrens, Case, Ryan</i>
<i>Rink Bk D. Col. 1987</i>	?		<i>Horton</i>

<i>Rosteck II</i> N.D. Ill. 1988	7	<i>Harvey, Rink, Stern, Strelsky</i>
<i>Stern</i> Bk D. Mass. 1984	7	Massachusetts Statute
<i>Strelsky</i> Bk. E.D. Va. 1985	7	Statute