***In re Pearson*, Case No. 18-10502 (Bank. D. Del. (BLS)) – Delaware statute of limitations for note and mortgage or other contract involving less than $100,000 and executed under seal is 20 years (three years if unsealed) (Erin Brignola)**

**Relevant Provisions: 10 Del. Code § 8106 and Delaware Common Law**

**Summary:**

Issue: Whether a claim for breach of a mortgage and note executed under seal and in the original amount of $97,500 was subject to a three-year statute of limitations under 10 Del. Code § 8106 or a 20-year limitations period under Delaware common law.

Background: Chapter 13 debtor, Mr. Pearson executed a mortgage and note in the original amount of $97,500 in 2005. It was undisputed that the mortgage and note were executed under seal. The Debtor last made a mortgage payment in July 2008 and was in substantial default by the time he filed his chapter 13 petition in May 2018. Secured creditor Mellon, filed a proof of claim in connection with the mortgage and note in the amount of $190,120.07. Debtor objected to the claim on the grounds that it was time barred under the statute of limitations imposed by 10 Del. Code § 8106.

Holding and Analysis: The Court held that Mellon's claims under the sealed mortgage and note were subject to a 20-year limitations period under Delaware common law.

Section 8106(a) generally provides that a claim for breach of contract must be made within three years. However, section 8106(a) specifically exempts sealed agreements from this three-year statute of limitations.[1] Instead, Delaware common law controls and provides that causes of action based on a sealed agreement are subject to a 20-year limitations period.

The 2014 amendment to section 8106, which added subsection (c), does not change this result and does not abolish the common law limitations period for sealed agreements.[2] Instead section 8106(c) is merely intended to provide parties flexibility to include an agreed limitations period for asserting claims under a written contract (irrespective of whether the contract is sealed or unsealed); provided that (1) the contract involves at least $100,000 and (2) the agreed limitations period does not exceed 20 years.

This interpretation of section 8106(c) is consistent with the legislative history which indicated that the purpose of including the new subsection was to give "clear statutory authorization to the

[1] 10 Del. Code § 8106(a) provides in relevant part that "no action to recover a debt not evidenced by a record or by an instrument under seal… shall be brought after the expiration of 3 years from the accruing of the cause of such action[.]"

[2] 10 Del. Code § 8106(a) provides in relevant part that

> Notwithstanding anything to the contrary in this chapter… an action based on a written contract, agreement or undertaking involving at least $100,000 may be brought within a period specified in such written contract, agreement or undertaking provided it is brought prior to the expiration of 20 y6ears from the accruing of the cause of such action.

parties' freedom to contract beyond the three- or four-year statutory period without resorting to the use of a sealed instrument, as long the contract involves at least $100,000 and is in writing."

Notably, the implication remains that there is no freedom to include an agreed limitations period in contracts involving less than $100,000. Those contracts remain subject to the three-year statute of limitations of 10 Del. Code § 8106(a) if unsealed and the 20-year common law limitations period if sealed.

***Feldman v. People First Federal Credit Union* (*In re White*), 600 B.R. 335 (Bankr. E.D. Pa. 2019) (Fehling, J.) – payment by chapter 7 debtor to lender, with proceeds from her 401(k) received by the debtor *prepetition* in the form of a check, which the debtor endorsed, deposited with her counsel, and cause to be paid to lender post-petition, was avoidable as an unauthorized post-petition transfer under Code section 549 (Erin Brignola)**

**Relevant Provisions: Code § 549**

**Summary:**

Well before filing a chapter 7 bankruptcy, the debtor had fallen behind on payments to the mortgage lender on her house. In order to cure the arrears, she requested a check for approximately $45,000 (on a total balance of about $63,000) from her 401(k) administrator as a "hardship withdrawal." She received the check minutes before filing for bankruptcy. After she filed the case, she endorsed the check and gave it to her attorney who then deposited it into his IOLTA account and then paid the funds to the lender. The chapter 7 trustee filed a complaint against the lender seeking to avoid the transfer of the $45,000 as an unauthorized post-petition transfer of property of the estate under 11 U.S.C. §549(a). After denying the lenders' motion to dismiss, the parties filed cross-motions for summary judgment.

The lender defended with two arguments. First, the funds were not property of the estate under the "earmarking doctrine," which holds that when a third party makes a loan to a debtor to enable the debtor to satisfy the claim of a designated creditor, the loan proceeds are not considered property of the debtor because they have been "earmarked" to pay the designated creditor. Second, the funds were exempt because the trustee failed to object to the debtor's schedule of exemptions, which listed the entire $63,000 on deposit in the 401(k) account *before* the withdrawal of the $45,000.

The Court granted the trustee's motion for summary judgment. Preliminarily, the Court did not rule on the trustee's argument that the earmarking doctrine does not apply to post-bankruptcy transfers. Rather, the Court concluded that the doctrine did not apply because there was no "second lender." As to the issue of the exemption, the Court held that the trustee's failure to object to the schedule of exemptions was of no moment, because once the funds were withdrawn from the 401(k) account, there was nothing left to exempt other than the funds that remained in the account.

***In re Dahman*, Case No. 18-12199 (Bankr. D. Del. (BLS)) – failure to raise a usury defense to a claim in a prior bankruptcy case can preclude the debtor's raising such defense in a subsequent bankruptcy case on the ground of *res judicata* or claims preclusion**

**Relevant Provisions: Code § 502**

**Summary:**

The Court had to decide whether a proof of claim that passed through a former bankruptcy case without objection was binding for purposes of *res judicata* or claims preclusion. In order for a claim to have *res judicata* effect, there must be a final judgment on the merits in a prior suit, involving the same parties, and the subsequent suit must be based on the same cause of action. In this case, the only element at issue was whether there was a final judgment on the merits.

Debtors granted Tuoni Investments LLC a mortgage and bond in exchange for $40,000. The bond charged a 24% interest rate and had a 10-year maturity date. A balloon payment was due on the date of maturity. The Debtors consistently made payments toward the interest on the bond but failed to pay the $40,000 balloon payment on the maturity date. Prior to expiration of the 10-year term, Debtors filed for a chapter 13, and the case was converted to chapter 7. Tuoni filed a proof of claim. The Debtors did not object to the claim and continued to make payments on the claim.

Two decades after the original petition, Debtors filed a new chapter 13 petition and Tuoni again filed a proof of claim, seeking the $40,000 principal plus interest on the same claim. This time, Debtors objected, asserting that the 24% interest rate was illegal under Delaware's usury statute, which capped the interest rate at the time at 10%. If the usury statute applied, the Debtors should have owed only $64,000 and their payments totaling $73,000 should have fully relieved them from liability. Tuoni argued that *res judicata* barred the Debtors from raising the usury issue, because they did not object to the claim in the former bankruptcy case.

Under 11 U.S.C. § 502, a claim is deemed allowed unless a party in interest objects. The leading Ninth Circuit case, *Siegel v. Fed. Home Loan Mortg. Corp.*, addressed the issue of whether a claim that had been deemed allowed for lack of objection was "actually litigated" as to give it preclusive effect. The Ninth Circuit held that a claim that has been deemed allowed for lack of objection has the same effect as one that has been allowed through a formal court order, questioning "what else can 'deemed allowed' mean? It must mean deemed allowed by the court." While the Court addressed that there was doubt about the finality of a claim when it could still be contested at a later time, it held that there is no such doubt after the Debtor receives a discharge and the bankruptcy has closed.

The bankruptcy court found the Ninth Circuit's rationale persuasive and held that an uncontested proof of claim that has been allowed under 502(a) is a final judgment on the merits for purposes of *res judicata*. Because the Debtors did not assert a usury defense in their prior bankruptcy, the defense was deemed waived.

As a result of their failure to timely raise the usury defense, the Debtors' objection was overruled.

***In re Denby-Peterson*, 941 F.3d 115 (3rd Cir. 2019) – turnover not self-executing and passive continued possession of estate property is a stay violation, with a reference to *In re Fulton*, on certiorari to the Supreme Court this term (Bruce Grohsgal)**

**Relevant Provisions: Code §§ 362(a)(3), 362(k) and 542(a); Rule 7001(1)**

**Summary:**

Denby-Peterson bought a Chevrolet Corvette sports car on time, the lien against which was held by NU2U Auto World. Denby-Peterson missed some of the installment payments, and NU2U repossessed the car.

Denby-Peterson then filed her chapter 13 petition. She also filed her motion, requesting (1) turnover of the Corvette to her under section 542, and (2) sanctions against NU2U for its alleged violation of the automatic stay by retaining control and possession of the car post-petition, in violation of Code section 362(a)(3), including costs and attorneys' fees, compensation for "non-economic damages," and punitive damages under section 362(k). The bankruptcy court (Altenburg, D.N.J.), ordered turnover. But, stressing that the debtor's interest in the car was not clear, the court followed the minority of the courts of appeals, and held that NU2U's merely retaining possession of the car post-petition while the debtor's interest in the car was adjudicated was not a stay violation. The district court affirmed and the debtor appealed.

Code Section 362(a)(3) provides that the filing of the petition "operates as a stay … of … any act to … exercise control over property of the estate. The Third Circuit's consideration turned on its analysis of this text. NU2U had possession and control of the Corvette post-petition, it was true. But it did not commit – by merely by holding onto the Corvette – "the requisite post-petition affirmative 'act ... to exercise control over'" the car. Thus, it did not violate the automatic stay. The court also noted that the purpose of the automatic stay is to maintain the *status quo*, which NU2U's retention of possession had not disturbed.

The Third Circuit then turned to the question of whether the turnover requirement of Code section 542 is "self-executing," and held that it is not. The court emphasized that Bankruptcy Rule 7001(1) provides for a proceeding for turnover, i.e., that turnover sought by a trustee against a debtor must be commenced by an adversary proceeding, and also that section 542 contains sets forth both requirements for and exceptions to the turnover. The court did not find persuasive that section 542(a) expressly requires that an entity "in possession, custody, or control, during the case," of property of the estate "*shall* deliver to the trustee, and account for, such property or the value of such property" (emphasis supplied), or that the statute itself imposes no obligation on a trustee or debtor in possession to commence an adversary proceeding or file a motion. The court found further support for its conclusion in *Citizens Bank of Maryland v. Strumpf*, in which the Supreme Court held that section 542(a) does not require a bank to turn over to a debtor the funds in the debtor's bank account pending a determination of the bank's setoff rights against the account.

The Circuit split on these issues, or at least some of them, should be resolved soon. The Supreme Court recently granted *certiorari* in *In re Fulton* (7th Cir.) and related cases arising from the City of Chicago's taking possession of cars for unpaid tickets and refusing to return them post-petition. The question before the Court is: "Whether an entity that is passively retaining possession of property in which a bankruptcy estate has an interest has an affirmative obligation under the Bankruptcy Code's automatic stay, 11 U.S.C § 362, to return that property to the debtor or trustee immediately upon the filing of the bankruptcy petition."

***In re Porter*, Case No. 18-10669 (Bankr. D. Del. (BLS)) – Objection to POC for projected escrow shortage overruled under FBRP 9009, Local Rule 3023.1(b)(ii)(D) and official Form 410A.**

**Summary:**

Debtors filed a chapter 13 plan which stated $0 arrears pre-petition as Debtors were contractually current on the mortgage when the petition was filed. The POC included $332.46 in arrears for a projected escrow shortage. Debtors objection was that on the petition date, the escrow account had a balance of $1412.04 to cover the estimated escrow needed to pay taxes and insurance , and since the tax and insurance payments would occur post-petition, that a post-petition escrow analysis would cure the problem and thus no shortfall pre-petition had occurred. Practically speaking, treatment in any other fashion will cause further costs to the Debtors in the commission added to pay the pre-petition mortgage arrears claim if allowed, and the post-petition expense of the creditor's attorney fees in participating in the bankruptcy process, via plan objection.

PennyMac's argument was the Debtors would owe $1745.04 over the 12 months following the Petition date and thus the account was short $332.46 on the date of filing. Since official Form 410A includes the projected escrow deficiency in the calculation of the prepetition arrears and the form is to be used "without alteration", the claim must be prepetition. The Court agreed that Rule 9009 provides that the Official forms shall be used without alteration and that Local Rule 3023-1(b)(ii)(D) provides that "mortgagees shall not include any pre-petition costs or fees or prepetition negative escrow in any post-petition escrow analysis. These amounts shall be included in the prepetition claim amount unless the payment of such fee or costs was actually made by the servicer".

The Court left open the door as to whether the Parties wished to confer and reach an agreement amongst themselves—This Court has approved Stipulations to pay these relatively small claims directly to minimize the Debtor's extra costs.