WESTERN BANKERS ASSOCIATION

2021 BANK COUNSEL SEMINAR

A BRAVE NEW WORLD:
New Laws that Change the Playing field for Real Estate Lenders.

Panelists:

JEANNINE DEL MONTE KOWAL
Senior VP, Associate General Counsel
Pacific Western Bank

BARRY SMITH
Shareholder
Buchalter

Moderator:

PETER S. MUÑOZ
Counsel
Reed Smith, LLP

Program Reference Materials

ATTACHMENT A

Memorandum Re: AB 3088 – Tenancy: Rental Payment Default: Mortgage Forbearance: State of Emergency: COVID-19
Date: May 27, 2021
By: Peter S. Muñoz

I. INTRODUCTION.

On August 31, 2020, Governor Newsom approved AB 3088 as an emergency measure that went into effect immediately. AB 3088 made important changes in many different California statutes. Two of those changes have an important impact on lenders holding liens on residential property of 1-4 residential units, borrowers who own such properties and tenants who occupy such properties. AB 3088 modifies California Civil Code 2924.15 and enacts California Civil Code Section 3273.01 through 3273.16.

This memorandum will focus on the changes to Civ. Code § 2924.15 and on Civ. Code §§3273.01 through 3273.16 and will discuss the requirements of the statutory enactments and the potential problem areas. It is important to note that at the time AB 3088 was being considered, there were a plethora of competing pieces of legislation all seeking to address the economic chaos created by the Covid-19 Pandemic for borrowers, lenders and tenants. There are material issues regarding AB 3088 that lenders might point out (many of which are pointed out below). However, in view of the many competing bills that were being considered, AB 3088 was perhaps the best of the lot considering the alternatives. Kevin Gould and his team can be commended for keeping the problem areas to a minimum.

II. CIVIL CODE SECTION 2924.15.

A. HBOR

Section 2924.15 was originally enacted in 2012 along with the rest of the California Homeowners' Bill of Rights ("HBOR"). The HBOR (CC 2924(a), 2923.5, 2923.55, 2924.6, 2923.7, 2924.9, 2924.10, 2924.11, 2924.18) imposed certain obligations on lenders before they can conduct non-judicial foreclosures on owner-occupied residential property of 1-4 residential units that: (i) is occupied by the owner as the owner's principal residence; and (ii) is subject to a first-priority lien to secure a loan to the owner made for personal, family or household purposes (hereafter the "Specified Property").

In brief, a lender holding a defaulted consumer loan secured by 1-4 unit residential property was required to work actively with the owner to determine if the owner qualified for a "Foreclosure Prevention Alternative" offered by the lender. The lender was required to provide certain notices to the owner of the potentially available Foreclosure Prevention Alternatives and offer the owner an opportunity to file an application for such Foreclosure Prevention Alternative. If the lender determined that the owner did not qualify for any Foreclosure Prevention Alternative, the lender was required to provide an explanation to the owner why the owner did not qualify and provide the owner an opportunity to correct any defects or errors in the owner's application and to appeal the lender's adverse determination. To protect the owner, the lender was prevented from proceeding with a foreclosure until the entire process was completed.

The entire process resulted in a lengthy delay in commencing or continuing with a non-judicial foreclosure of between 2 to 6 months in addition to the prior-existing statutory time periods. That delay often motivated lenders to agree to a Foreclosure Prevention Alternative in order to have the owner commence payments of the newly restructured loan payments.

As noted, the HBOR applied only to situation where the lender made a consumer loan and where the residential property is occupied by the owner.

B. **AB 3088.**

Under AB 3088, the scope of the HBOR is extended to apply to residential property of 1-4 residential units that are **not owner-occupied** and to loans that are **not for personal, family or household purposes** (i.e. not consumer loans).

Revised CC 2924.15 now applies to in two situations:

1. It will continue to apply to residential property of 1-4 residential units that is occupied by the owner as the owner's principal residence, which is subject to a first-priority lien to secure a loan to the owner made for personal, family or household purposes.

2. In addition it will now apply to residential property of 1-4 residential units that is occupied by a tenant under a lease as the tenant's principal residence which is subject to a first-priority lien to secure a loan to the owner provided that:

a. the lease is an "applicable lease", meaning that it (i) was entered into in good faith and (ii) for valuable consideration that reflects the fair market value of on the open market;

b. the lease was entered into before and in effect on March 4, 2020;

c. the property is owned by an individual who owns no more than three (3) residential real properties each of 1-4 residential units; and

d. the tenant occupying the property is unable to pay rent due to a reduction in incoming resulting from the novel coronavirus.

This new addition remains in effect until **January 1, 2023**. At that time, the text of CC 2924.15 reverts to what it originally was.

C. **Impact of AB 3088**

AB 3088 is intended to protect small property owner borrowers who are suffering from a reduction in their rent revenue because of the adverse impact that the novel coronavirus has on the ability of the property owner's tenants to pay their rent.

Except for the change to CC 2924.5, the new law does not add any new criteria or protocols to the other provisions of the HBOR. Therefore, it should not impose many new unfamiliar burdens on most institutional lenders who have already adopted procedures and protocols for dealing with requests under the HBOR. However, it will give rise to a large number of new requests for restructure. Moreover, the lenders must adapt their application forms to take into account new variables related to the fact that the real property is rental property (such as: rent revenue, and expenses tenant improvements and property maintenance) that are not usually relevant where the collateral is an owner-occupied residence.

Finally, there are a few points that are problematic:

(i) how is the property owner to prove that the subject real property is the principal residence of the tenant -- will a declaration by the tenant be sufficient?

(ii) how is the property owner to prove how few properties are owned -- will a declaration by the property owner be sufficient?

(iii) once the property owner's loan has been restructured, will restructure loan remain in place if the original tenant moves and is replaced by a tenant who has a stronger financial position? (Perhaps that can be addressed in drafting the Foreclosure Prevention Alternative.)

III. **CIVIL CODE 3273.01 *ET SEQ*.**

The COVID-19 Small Landlord and Homeowner Relief Act (CC 3273.01 *et seq*.) (hereafter the "Act") is deceptively simple and non-threatening. However, it is fraught with potential risk to a lender that fails to agree to a forbearance agreement with the borrower or fails to offer the borrower a "loss mitigation" alternative.

To better understand and interpret the Act, we should consider its two predecessors: the California Homeowners' Bill of Rights ("HBOR) and the Federal CARES Act. We should also keep in mind that the drafters were sensitive to the limitations on the State's ability to mandate certain actions or results due to Federal Preemption issues. Therefore, it benefited the State not to be too specific since there was preexisting Federal legislation on the subject matter.

A. **Relevant Provisions of the Act.**

CC Section 3273.12 states, "It is the intent of the Legislature that a mortgage servicer offer a borrower a post forbearance loss mitigation option that is consistent with the mortgage servicer's contractual or other authority. Note: the statement is made as a statement of an "intent" and not as a mandatory requirement. Granted this approach in the Act will likely enable the legislation to survive a challenge of Federal preemption. However, it does open the door to litigation.

CC Section 3273.10 imposes certain obligations on mortgage servicers upon denying a "forbearance request" (a term that is not defined). If the mortgage servicer denies any forbearance request, the mortgage servicer shall provide written notice (hereafter "Notice of Denial") to the borrower that sets forth the specific reason or reasons that the forbearance was not provided if:

(i) the borrower was current on payments as of February 1, 2020 and

(ii) the borrower experienced financial hardship that prevented the borrower from making timely payment on the mortgage due, directly or indirectly, to the COVID-19 emergency.

If the Notice of Denial cites any defect in the borrower's request (including an incomplete application or missing information) the mortgage servicer shall:

(i) Identify the curable defect in the Notice of Denial,

(ii) provide 21 days from the mailing date of the Notice of Denial for the borrower to cure any identified defect,

(iii) accept receipt of borrower's revised request for forbearance before said 21-day period expires.

(iv) respond to borrower's revised request within five business days of receipt.

CC 3273.10(c) provides that if the mortgage servicer denies a forbearance request and later proceeds with a non-judicial foreclosure, the declaration required under Section 2923.5(b) must include a statement whether forbearance was or was not subsequently provided. Note: this Section does not

indicate whether granting the forbearance or denying the forbearance has any effect on the application of CC 2923.5(b).

CC 3273.11 and CC 3273.10(d) provide in essence that if the lender complies with various Federal statutes which provide for COVID-19 related forbearance, such compliance will be deemed to be compliance with the Act.

CC 3273.16 provides that any waiver of the provisions of this Act shall be void. Note: presumably, this section refers to any **advance** waiver; and does not refer to any waiver after a cause of action has accrued.

CC 3273.15 provides that "any borrower who is harmed by a material violation [of the Act] may bring an action to obtain injunctive relief, damages, restitution, and any other remedy to redress the violation." Such relief shall include borrower's attorneys' fees: (i) in any action in which injunctive relief (including a temporary restraining order) is granted against a sale [presumably where the borrower is the moving party] and (ii) in any action for violation of the Act in which the borrower is the prevailing party even if injunctive relief against a sale is not granted.

CC 3273.1(b) provides a cryptic indirect reference to the termination date of the Act. The definition of the term "Effective time period" (used elsewhere in the Act) is stated as 'the time period between the operation date of this title and April 1, 2021. Note: presumably, **April 1, 2021** is the termination date of the Act; however, as indicated above other provisions of AB 3088 expressly.remain effective until **January 1, 2023.**

CC 3273.1 and 3273.2 define the scope of the Act. However, the language of these two sections requires careful examination.

1. <u>Borrower.</u>

The term "'Borrower" **will** include:

a. A **natural person** who is the mortgagor, trustor under a deed of trust or mortgage or any confirmed successor in interest to such mortgagor or trustor.

b. An **entity** only if the encumbered property contains no more than four dwelling units and is currently occupied by one or more residential tenants.

c. Any **person** who holds a power of attorney for any of the foregoing.

The term "Borrower" **will not** include:

a. An **individual** [a natural person? Or an entity?] who has surrendered the encumbered property as evidenced by a letter [any written document?] or by delivery of the property's keys to the mortgagee, trustee, beneficiary or their authorized agent. (This provision is similar to that included in CC 2920.5 of the HBOR.)

b. Unless the property encumbered contains one or more deed-restricted housing units subject to regulatory restriction limiting rental rates contained in an agreement with a governmental agency,

(i) A real estate investment trust;

(ii) A corporation;

(iii) A limited liability company in which at least one member is a corporation.

2. Mortgage Servicer/Lienholder.

The term Mortgage Servicer and Lienholder is very broadly defined and includes the current owner of the note, or the current owner's authorized agent, or the person or entity that directly services the loan or interacts with the borrower, manages the loan account on a daily basis, manages any escrow account, enforces the note of the security instrument. Also included is any subservicing agent under a master servicing agreement. Note: Presumably, the term also **includes** the beneficiary under a deed of trust or mortgagee under a mortgage. (This provision is similar to that included in CC 2920.5 of the HBOR.)

The term **does not include** a trustee or a trustee's authorized agent acting under a power of sale.

3. The Deed of Trust or Mortgage.

The Act will apply to any mortgage or deed of trust that encumbers residential property consisting of 1-4 residential units (including condominiums, cooperatives) and that was in effect as of the effective date of the Act.

4. Lenders Covered.

The Act applies to virtually all lenders licensed or chartered under federal or state law and to virtually all persons licensed under state non-bank lending statutes. (This scope is similar to that provided for in CC 2923.7 and 2924.18 of the HBOR.)

B. **Comments.**

1. Confusing Language and Provisions.

The Act is confusing in many aspects.

a. Terminology. Some of the terminology of the Act is confusing. There are references to "natural persons", "persons", "individuals", "entities". However, it is unclear whether these terms are separate and distinct or are overlapping to any degree.

b. Forbearance Request. The Act uses language similar to that in the federal CARES Act. The concepts of "forbearance" and "default" appear to apply to failure of the borrower to pay regular contractual payments.

However, there are many different events which can constitute events of default under a loan secured by residential real property, besides the failure to maintain contractually obligated payments. Some are monetary defaults (failure to pay the note, failure to pay taxes); some are breaches of covenants that are related to failure to pay certain obligations to third parties (failure to maintain insurance, failure to pay taxes, failure to keep the property free of liens); some are defaults in performance (waste on the subject property, sale or leasing of the property); some are financial covenants (maintaining certain net worth). Moreover, some home construction loans include covenants requiring obtaining permits and compliance with local ordinances.

The question then is raised how should such defaults be treated. Perhaps, the Cares Act and decisions thereunder might provide some guidance. One logical conclusion is that a monetary default might be treated differently than a non-monetary default and could be considered a legitimate reason for not granting any forbearance. However, a monetary default arising from a COVID-related cause should be seriously considered for a forbearance under the Act.

c. Intent of the Legislature. Section 3273.12 contains a general statement that certain results are the "intent of the Legislature". Such language might be interpreted to mean that if those results are not achieved the lenders are in violation of the statute. How is a lender to determine what precise actions are sufficient to satisfy this generalized statement of the intent of the Legislature.

d. Limited Partnerships. It is clear that under Section 3273.1 the definition of "borrower" is meant to apply as much as possible to natural persons and associations of natural persons. This appears to be the case since corporations are excluded from qualifying as a "borrower" and so are LLC's in which a corporation is a member. However, that definition fails to exclude limited partnerships. This leaves a large gap since many limited partnerships have as their general partner corporations or LLC's in which the managing member is a corporation. This situation then raises the question whether Section 3273.1 intentionally omitted limited partnerships from the exclusion or whether this omission was an oversight.

e. HBOR. It appears that the Act was enacted to provide an incentive for a lender to agree to a forbearance period to a borrower who is not in compliance with the payment provisions of a residential loan (and to provide a post-forbearance "loss mitigation" option as stated in CC 3273.12). This appears to overlap to some extent with the purpose of the HBOR which prevents a lender from foreclosing and encourages the lender to provide the lender a "Foreclosure Prevention Alternative". One might assume that the Act and the HBOR were two sides of the same coin, and that compliance with HBOR should satisfy all obligations under the Act.

However, the reference in Section 3273.10(c) to CC Section 2923.5 makes it appear that the Act and the HBOR impose separate burdens on lenders. If so, it would appear that a lender would have to: (i) provide a forbearance to the borrower, (ii) then explore the borrower's loss mitigation options under the Act, (iii) thereafter explore the Foreclosure Prevention Alternatives for the borrower under the HBOR.

This confusion is perhaps unavoidable since earlier versions of the Act attempted to mesh the requirements of the Act with the requirements of the HBOR but were unsuccessful in that attempt. The current language in the Act is probably the best case result.

f. Stay of Foreclosure. The HBOR contains provisions which expressly prevent a lender from commencing or continuing with a non-judicial foreclosure while the parties comply with the requirements of the HBOR. The Act does **not** contain any such prohibition. However, a lender should tread lightly in this area. The HBOR imposes certain requirements on the lender before it can commence foreclosure.

2. Potential Liability for Lenders.

The HBOR contains many provisions similar to those in the Act allowing the borrower to sue lenders for violation of the HBOR, to recover damages for that violation, to recover attorneys' fees if the borrower is successful in obtaining any injunctive relief (including a TRO) and to recover attorneys' fees if the borrower is the prevailing party in the litigation. Such provisions in the Act are not new.

However, these provisions in the Act present more risk and danger to lenders because of the uncertainty and lack of precision in the Act as described above. That uncertainty allows greater leeway for a jury to impose liability on a lender by concluding: (i) that a lender should have known either not to take certain action or to have taken certain other action; and (ii) therefore the lender violated the requirements of the Act.

ATTACHMENT B

Memorandum Re: Sub-chapter V of Chapter 11 of U.S. Bankruptcy Code.
Date: May 27, 2021
By: Peter S. Muñoz & Jeannine Del Monte Kowal

I. INTRODUCTION.

Effective February 19, 2020, Congress enacted new bankruptcy legislation granting Debtors the option to elect a new subchapter V of chapter 11 of the bankruptcy code (Subchapter V) under the Small Business Reorganization Act of 2019 ("SBRA"). Pub. L. No. 11654, 133 Stat. 1079.

SBRA was amended by the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020, Pub. L. No. 116-136, 134 Stat. 281 (effective March 27, 2020 for the period of one year) to increase the amount of debt that a party can hold to qualify for Subchapter V discussed below. That amendment was effective only for 1 year until March 27, 2021, which was then extended until March 27, 2022.

Subchapter V provides major benefits to a petitioning Debtor in submitting and confirming a plan of reorganization and "cramming down" objecting creditors. It appears to be a limited combination of a Chapter 11 case and a Chapter 13 case.

II. ANALYSIS.

A. **Qualifying Debtors**.

1. The Debtors who qualify for protection under Subchapter V are defined in § 101 (51D) as a person:

a. engaged in a commercial business activity, excluding the ownership of single asset real estate as defined in 11 U.S.C. §101 (51B);

b. has non-contingent liquidated secured and unsecured debt as of the date of the filing of the petition not more than $2,725,625.00

(i) excluding debts owing to affiliates and insiders,

(ii) The cap was increased to $7,500,000 under the CARES Act of 2020 the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020, Pub. L. No. 116-136, 134 Stat. 281. That change was effective for one year commencing March 27, 2020);

(iii) On March 27, 2021, the COVID-19 Bankruptcy Relief Extension Act of 2021 was signed into law. Among other relief, this legislation extends the higher $7,500,000 debt limit for subchapter V eligibility for another year. The new sunset date is March 27, 2022, and

c. the majority of such debts must have arisen from the commercial or business activities of the Debtor. [11 U.S.C. § 101 (51D)].

2. The foregoing list will exclude SPE (Special Purpose Entities) which own and manage one particular item of real property.

3. A Debtor under Subchapter V is not a debtor under a "small business case" as that term is defined and applied under 11 USC 362(d) (relating to relief from the automatic stay).

4. An individual that has a majority of commercial debt may file, also if the mortgage on the principal residence was used for business purposes it can be included..

B. **Powers of the Debtor**.

Subchapter V greatly improves the powers and ability of the Debtor to control the process of proposing and confirming a Plan of Reorganization.

1. **Filing a Plan**.

Only the Debtor can file a Plan. Subchapter V does not authorize creditors or interested parties to submit plans of reorganization. [11 U.S.C. § 1189(a) (2019)]

The Debtor also is not required to file a Disclosure Statement. Instead, the Debtor is required to include a brief history of the business operations, a liquidation analysis and projections demonstrating the Debtor's ability to make the payments provided for in the proposed plan. [11 U.S.C. §§ 1181(b) and 1190 (2019)]

2. **Absolute Priority Rule**. Under non-Subchapter V cases a dissenting class of unsecured creditors must be paid in full before any junior class can receive or retain property under a plan of reorganization. [§ 1129(b)(2)(B)(ii)]. That requirement is eliminated in Subchapter V cases.

3. **Cram-down and Voting**.

Subchapter V eliminates the requirements under § 1129(a)(10) that the debtor receive the acceptance of at least one impaired class has been eliminated. The Debtor in Subchapter V may confirm a cram-down plan without the approval of any class of creditors.

Under Subchapter V the court may confirm a plan over the objection of unsecured creditors, but the plan must not "discriminate unfairly" and must be "fair and equitable" for "each class of claims or interests that is impaired under, and has not accepted the plan." [§ 1129(a)].

The fair and equitable standard requires all projected disposable income of the Debtor, to be received in a three-year period or such longer period as the court may approve but not to exceed five years, will be applied to the plan. [11 U.S.C. § 1191(b) (2019).] [See discussion in Section C.5. below.] The plan must also provide "appropriate remedies" to "protect" creditors from a failure to make payments, including "the liquidation of nonexempt assets."

Post-petition assets and earnings are added to the estate until the case is closed, converted or dismissed. [11 U.S.C. § 1186.]

Because all property of the debtor and postpetition assets remain property of the estate, the automatic stay does not terminate at confirmation under § 362(c)(1).

4. **Modification of Certain Mortgages**.

Subchapter V enables the Debtor to modify the rights of certain holders of claims secured only by a security interest in the Debtor's principal residence when the proceeds of the relevant mortgage were used primarily in connection with the Debtor's business. [11 U.S.C. § 1190(3) (2019).]

Of course, this provision would probably not allow the modification of a purchase-money mortgage.

WARNING for Home Businesses: *In re Ventura*, 615 B.R. 1 (Bankr. E.D.N.Y. 2020) owner of a home used real property used as both primary residence and bed and breakfast was found eligible to be a small business under the SBRA. The fact that a debtor incurs mortgage debt to buy a residence does not guarantee the debt will be treated as consumer debt. "The test for determining whether a debt should be classified as a business debt, rather than as a consumer debt, is whether it was incurred with an eye toward profit...[c]ourts must look at the substance of the transaction and the borrower's purpose in obtaining the loan, rather than merely looking at the form of the transaction." (*Citing, In re Martin*, No. 12-38024, 2013 WL 5423954, at *6 (S.D. Tex. Sept. 26, 2013). *See also, In re Booth*, 858 F.2d 1051, 1055 (5th Cir. 1988) (a debt incurred with an eye toward profit is a business debt, rather than consumer debt.).

5. **Payment of Administrative Expenses**.

Subchapter V permits the Debtor to pay administrative expenses over the life of the Plan. This can be a major advantage in many bankruptcies where the Debtor does not have the funds to pay the administrative expense claims at the beginning of the Plan.

However, this right is limited in a Subchapter V case to a plan that is approved pursuant to the cram-down provisions of new § 1191(b). 26 § 1191(e) that is a Plan which has not been approved by the creditors. [The rationale for this is that the Trustee (discussed below) terminates its responsibilities upon confirmation of a consensual Plan; and does not terminate its responsibilities until substantial completion of a contested plan.]

6. **Remedies upon Default**.

New § 1191(c) requires the plan to provide appropriate remedies to protect the holders of claims and interest in the event that plan payments are not made. The Debtor can avoid this requirement by showing the court **with certainty** that the Debtor will be able to make all payments under the plan. Such certainty is not easy to prove.

This requirement should provide leverage for the creditors and grounds to dismiss any subsequent chapter 11 petition that the Debtor may file since the existing plan already provides for the liquidation of the Debtor's assets upon a plan default.

7. **Discharge**.

Subchapter V allows a small business Debtor to obtain a discharge **on the effective date of the plan**, provided the plan was consensual and approved under the new § 1191(a), which requires compliance with all of the consensual confirmation provisions in a typical chapter 11 case. [§§ 1191(a), 1129(a), and 1141(d)(1)(A) (2019).]

However, if the plan is not consensual the discharge is effective **after plan payments are completed.** [11 U.S.C. §§ 1181(c) and 1192 (2019).]

In addition, a corporate Debtor may be able to obtain a discharge under Subchapter V even if the plan is a nonconsensual liquidating plan. [11 U.S.C. § 1181(c) (2019).]

However for small business debtors, Subchapter V makes applicable the nondischargeability provisions of § 523(a), 23 § 1192(2), thus preventing a corporate Debtor from discharging fraud, tax, and other nondischargeable claims.

8. **Modification of Plan**.

After confirmation, only the Debtor may modify the plan. [17 11 U.S.C. § 1193 (2019).] Under non-Subchapter V reorganizations, when the Debtor is an individual § 1127(e) permits the Trustee, U.S. Trustee, or the holder of an allowed unsecured claim to seek a modification to (i) increase or reduce the amount of payments, (ii) extend or reduce the time-period for such payments, or (iii) alter the amount of distribution to a creditor at any time before the completion of payments under the plan. § 1127 is not applicable in a Subchapter V case. [11 U.S.C. § 1181(a) (2019).]

Therefore, in a Subchapter V case, if the Debtor's business improves significantly during the course of the plan, there is no provision that would permit a creditor to request modification of the plan to increase payments.

C. **Restrictions on the Debtor.**

1. **Use of Cash Collateral**.

A Debtor under Subchapter V must comply with all the provisions of the Code that limit the Debtor's right to use a creditor's cash collateral. Debtors filing cases under Subchapter V will still have to obtain an agreement on the use of a creditor's cash collateral or otherwise be able to provide adequate protection of the creditor's interest in cash collateral. [11 U.S.C. §§ 363, 361.]

2. **Appointment of Trustee**.

Subchapter V requires appointment of a Trustee in every case. [11 U.S.C § 1183 (2019).]

However, the Trustee generally will not operate the Debtor's business. Instead, the Trustee's duties are intended to: (i) assist the Debtor in proposing and confirming a plan; (ii) making distributions under the plan; (iii) being accountable for all funds received from the Debtor; (iv) examining proofs of claims; (v) objecting to the allowance of claims that are improper; (vi) furnishing information concerning the estate as requested by a party in interest; and (vii) opposing the discharge of the Debtor if appropriate. [§ 1183(b).]

The term of the Trustee's appointment will depend upon whether the plan is consensual or contested. If there is a consensual plan, the Trustee's services terminate when the plan has been substantially consummated [§ 1183(c)(1).]

In this situation, the Debtor is required to provide notice of substantial consummation to the Trustee, the U.S. Trustee, and all parties in interest. The Debtor must send the notice no later than fourteen days after substantial consummation of the plan. [§ 1183(c)(2).]

In a nonconsensual plan, unless the plan or the court provides otherwise, the Trustee is responsible for making distributions to creditors until the plan is complete. [11 U.S.C. § 1194(b) (2019).]

At that time, the Trustee is obligated to file a final accounting and a final report. [11 U.S.C. §§ 1106(a)(1), 704(a)(9) (2019).]

3. **Required Status Conference**.

The Debtor is required to be prepared to move the case along under Subchapter V. The court is required to hold a status conference within sixty days of the order of relief. [11 U.S.C. §§ 1188(a) (initial status conference)], 1189(b) ("[D]ebtor shall file a plan not later than [ninety] days after the order for relief . . . ."), 1121(e) (providing limit of exclusivity for 180 days in small business case) (2019). Within fourteen days prior to the status conference, the Debtor must file a notice with the court explaining the Debtor's progress in confirming a consensual plan. [40 11 U.S.C. § 1188(c) (2019).]

4. **Accelerated Confirmation Schedule**.

Subchapter V requires the Debtor to file a plan within ninety (90) days (compared with 180 days for a small business debtor as provided under § 1121(e)) [11 U.S.C. § 1189]. This plan deadline may be extended by the Court "...if the need for the extension is attributable to circumstances for which the debtor should not justly be held accountable." [11 U.S.C. § 1189(b).]

5. **Application of Projected Disposable Income**.

The Debtor is required to devote to pay creditors all projected disposable income or its value to be received in a three-year period beginning on the day that the first payment is due under the plan. In the alternative, the Debtor may distribute property under the plan that is not less than the Debtor's projected disposable income over the three-year plan period. [11 U.S.C § 1191(c)(2)(B) (2019).] The court may require a longer period for payments or distributions, not to exceed five years.

6. **Remedies upon Default**.

New § 1191(c) requires the plan to provide appropriate remedies to protect the holders of claims and interest in the event that plan payments are not made. The Debtor can avoid this requirement by showing the court **with certainty** that the Debtor will be able to make all payments under the plan. Such certainty is not easy to prove.

This requirement should provide leverage for the creditors and grounds to dismiss any subsequent Chapter 11 petition (chapter 22) that the Debtor may file since the existing plan already provides for the liquidation of the Debtor's assets upon a plan default.

7. **Election to Subchapter V.**

Can a debtor elect to file a subchapter V if the debtor previously elected a different chapter? The prevailing view is, “yes”.
See, *In re Ventura*, 615 B.R. 1 (Bankr. E.D.N.Y. 2020) (holding a debtor may amend her petition in a pending case to designate herself as a small business debtor and proceed under Subchapter V); *In re Twin Pines, LLC*, Case No. 19-10295-j11, 2020 Bankr. LEXIS 1217, *6 (Bankr. D. N.M. Apr. 30, 2020) (permitting debtor to elect Subchapter V status 387 days after petition date); *But see, In re Seven Stars on the Hudson Corp*., 618 B.R. 333, 346 (Bankr. S.D. Fla. 2020)(“Subchapter V by its very nature is intended to be an expedited process. It provides qualifying debtors with some powerful and cost-saving restructuring tools not otherwise available to Chapter 11 debtors.) *In re Wetter* (Bankr. W.D. Va. 2020) 620 B.R. 243, 251 (Conversion from chapter 7 to 11 denial is proper when there is an allegation that the Debtor is acting in bad faith or engaging in wrongful or dilatory conduct in either his chapter 7 case or in the process of conversion.)

8. **Removal of Debtor in Possession.**

Debtor in Possession can be removed, after notice and a hearing, “for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor, either before or after the date of commencement of the case.” 11 U.S. Code § 1185(a)

Debtor in Possession can also be removed for “failure to perform the obligations of the debtor under a plan confirmed” by the subchapter v court. 11 U.S. Code § 1185(a).

ATTACHMENT C

Memorandum Re: Right of First Refusal or Right to Over-bid on Foreclosed Residential Property
Date: May 27, 2021
By: Peter S. Muñoz

I. INTRODUCTION.

Effective November 18, 2020, Governor Newsom signed into law S.B. 1079 which was combined with portion of S.B. 1148 to make several very important changes to the process for completing non-judicial foreclosures on residential real estate and makes certain other changes to the occupancy and maintenance of the subject property.

S.B. 1079 modifies Civil Code Sections 2923.3, 2924f, 2924g, and 2924h; and it enacts new Civil Code Sections 2924m and 2924n.

The most significant changes to prior law are that following completion of auction process in a non-judicial foreclosure certain third party bidders are given an opportunity to match or exceed the highest bid received at auction unless the highest bidder at the auction is an existing tenant on the property being auctioned.

The ostensible purpose of this aspect of S.B. 1079 is to encourage the sale of foreclosed properties to the tenants on the property or to non-profit agencies whose primary activity is the development and preservation of affordable rental housing or to entities that are likely to use the land for the benefit of the public

II. ANALYSIS.

A. **Scope.**

1. **C.C. 2924m**. This section is new and provides certain parties the right to over-bid the highest amount bid received at the auction under C.C. 2924g.

a. **New Definitions**. There are three new defined terms.

(i) *"**Prospective owner-occupant**"* means a natural person who executes and presents to the Trustee under the Deed of Trust an affidavit ("Affidavit") that: (a) they will occupy the property as their principal residence within 60 days of the recording of the trustee's deed; (b) they will maintain such occupancy for at least one year; (c) they are not the trustor/ mortgagor or child, spouse or parent of the trustor/mortgagor; (d) they are not acting as the agent of any other person/entity in purchasing the real property.

(ii) *"**Eligible tenant buyer**"* means a natural person who at the time of the trustee's sale: (a) is occupying the real property as their principal residence; (b) is occupying the real property under a rental/lease agreement entered into in an arm's length transaction with the trustor/mortgagor on a date prior to the recording of the Notice of Default; and (c) is not the trustor/mortgagor, or the child, spouse or parent of the trustor/mortgagor.

*(iii) "**Eligible bidder**" means a bidder that qualifies under any of the following categories: (a) an eligible tenant buyer, (b) a prospective owner-occupant; (c) a nonprofit*

association, nonprofit corporation, or cooperative corporation in which an eligible tenant buyer or a prospective owner-occupant is a voting member or director; (d) an eligible nonprofit corporation based in California whose primary activity is the development and preservation of affordable rental housing; (e) a limited partnership in which the managing general partner is an eligible nonprofit corporation based in California whose primary activity is the development and preservation of affordable housing; (f) a limited liability company in which the managing member is an eligible nonprofit corporation based in California whose primary activity is the development and preservation of affordable rental housing; (g) a community land trust, as defined in clause (ii) of subparagraph (C) of paragraph (11) of subdivision (a) of Section 402.1 of the Revenue and Taxation Code; (h) a limited-equity housing cooperative as defined in Section 817; (i) the state, the Regents of the University of California, a county, city, district, public authority, or public agency, and any other political subdivision or public corporation in the state

b. **Opportunity for Over-bidding.** A trustee's sale under a power of sale in a deed of trust/mortgage on 1-4 residential units pursuant to CC 2924g shall not be deemed final until the earliest to occur of the following:

(i) If a prospective owner-occupant is the last and highest bidder, on the date upon which the conditions of CC 2924h for the sale to become final are met. The trustee will require the prospective owner-occupant to deliver the tenant-owner's Affidavit upon which the trustee may reasonably rely.

(ii) Fifteen days after completion of the auction **unless** at least one eligible tenant buyer or eligible bidder submits a **bid** pursuant to (iii) or (iv) below or submits a non-binding written notice to place such a bid, either of which must be received by the trustee not later than 15 days after the auction

(iii) The date on which a representative of all eligible tenant buyers submits a bid in an amount equal to the full amount of the last and highest bid at the auction in the form of cash or cashier's check **plus** an affidavit by the representative of the tenant-owner(s) stating that the persons represented meet the requirements for either an eligible tenant buyer. The bid and the affidavit of the representative of the tenant buyer(s) must be **received not later** than 45 days after the completion of the auction. If so, the eligible tenant buyer(s) will be deemed the last and highest bidder pursuant to the power of sale.

(iv) Forty-five days after the auction, provided however that during such 45-day period an eligible bidder may submit to the trustee a bid that exceeds the last and highest bid at the auction in the form of cash or cashier's check plus an affidavit identifying the category under which the eligible bidder qualifies. Said bid and the affidavit must be received by the trustee not later than 45 days after the auction. As of 5 p.m. of the 45th day after the auction, the eligible bidder that submitted the highest bid shall be deemed the last and highest bidder pursuant to the power of sale. The trustee will return any losing bid to the eligible bidder that submitted it,

c. **Notice for Potential Over-bidders**. If a prospective owner occupant is not the highest and last bidder at the auction, Section 2924m (d) imposes certain specified obligations on the trustee to provide for a period of 45 days following the auction on an internet website identified in the Notice of Sale all appropriate information for an eligible bidder and an eligible tenant buyer to submit a bid. [

d. **Termination Date**. This section shall remain in effect only until January 1, 2026 unless deleted or extended by later legislation.

2. **C.C. 2924g.** Section 2924g is amended to prohibit a trustee from bundling residential properties at a foreclosure sale under power of sale and that each property be bid on separately unless the deed of trust requires otherwise.

B. **Other Important Provisions.**

1. **C.C. 2924n**. Section 2924n is a new and makes it clear that "nothing in this article" shall relieve the person deemed to be the legal owner of the real property from complying with the applicable laws relating to eviction and displacement of tenants including without limitation, the requirement to provide relocation assistance, right to return and just cause eviction.

2. **C.C. 2929.3**. Section 2929.3 is a statute that was enacted during the beginning of the Great Recession: (i) to require a legal owner to maintain vacant residential property purchased by the owner at (or through) a foreclosure sale of vacant residential property and (ii) to allow a governmental entity to impose a civil fine if after notice of the failure to maintain, the legal owner fails to commence and complete correction of the violation within the specific periods set forth in the statute. The maximum civil fine permitted was $1,000.00 per day.

The amendment to CC 2929.3: (a) increases the maximum civil fine permitted to $2,000.00 per day for the first 30 days and $5,000.00 per day thereafter and (b) makes it clear that the fine is permitted but not required.

III. **COMMENTARY.**

A. **C.C. 2924m.**

1. **Inconsistencies and Uncertainties.** There are certain inconsistencies in the text which are probably attributable to the fact that the S.B. 1079 had major revisions at its later stages and when it was combined with S.B. 1148.

a. "**After the Trustee's Sale**". C.C. 2924m expressly states that the trustee's sale is not deemed final until the prospective owner-occupant, eligible tenant buyer and the eligible bidder have either had an opportunity to bid and did not take that opportunity or, alternatively, did submit a bid and completed the process set forth in the statute. Nevertheless, there are various provisions that provide for certain actions to be taken within so many days "after the trustee's sale". It is logical to assume that the reference "after the trustee's sale" was intended to mean "after completion of the auction". This memorandum incorporates that assumption.

b. **Representative**. There is a reference in 2924m (c) (3) to certain action being taken by the representative of **all** eligible tenant buyers. Yet the preceding Section 1924(c) (2) states that at least one tenant buyer can take said action. Therefore, it would not be logical to interpret the language in 2924m (c)(3) to mean that said action can be taken only by the representative of all or that any individual tenant buyer cannot take said action on their own.

c. **Nature of Title**. There is a reference in 2924m (c)(3) that if a representative of multiple tenant buyers submits a bid that meets all the requirement of that section, the multiple tenant buyers represented shall be deemed to be the highest and last bid. Does that mean that the multiple tenant buyers will become tenants in common? Or, alternatively, will they be joint tenants?

d. **Written (or Any) Lease Required?** The definition of "eligible tenant buyer" includes a requirement that said person be occupying the subject real property as their primary residence under a lease agreement entered into as the result of an arm's length transaction prior to the

recording of the Notice of Default. There is no explicit requirement that the lease be in writing. Other tenant relief statutes require that the tenant be occupying the subject property under a written lease. Therefore, we must logically conclude that no written lease is required, even though this situation presents the opportunity for abuse by unscrupulous individuals who might be interested in taking advantage of the right to over-bid.

The definition of prospective owner-occupant does not have an express requirement that the prospective owner-occupant be occupying the subject property in accordance with an arm's length lease agreement prior to the recording of the Notice of Default. Therefore, the prospective owner-occupant can be any natural person wholly unrelated to the subject property who is willing to provide an affidavit that: (i) after the trustee's sale, said person will occupy the subject property as their primary residence for a period of at least one year; (ii) they are not the mortgagor/trustor, any child or spouse or parent of the mortgagor/trustor; (iii) they are not the agent for any other person in purchasing the subject property.

This latter loophole does not comport with the stated purpose of the statute to protect the rights of tenants occupying the subject property. It would easily provide opportunities for individuals pejoratively referred to in the trade as "bottom feeders" who are looking to snap up potentially valuable bargains. All that is required is that the prospective owner-occupant is to live on the subject property for a year (during which time they could be preparing to "flip" the house at the end of that year).

2. **Dealing with the Right to Over-bid**. Prior to the enactment of S.B. 1079, a secured lender foreclosing on residential property, could conduct its credit bidding strategy in any way that it wanted in view of the projected value of the collateral and its available remedies to additional collateral or under guaranties. If the secured lender were the highest bidder, there was no reason for the secured lender to increase its bid.

a. **Easy Interest Free 45-day Delay**. The 45-day delay is easy for an eligible tenant buyer/eligible bidder to obtain by merely submitting a **non-binding** written notice to place such a bid. Moreover, if the secured lender is the last and highest bidder, the eligible tenant buyer/eligible bidder would **not** be required to pay any interest on the amount of the secured lender's bid since that amount is fixed as of the date of the auction. .

b. **Bidding**. Now that has changed since multiple third parties would be eager to exercise their rights to over-bid in situations where the final bid at auction is substantially below the true realizable value of the residential property. It would be prudent for the secured lender to have the property appraised by a reputable real property appraiser. The secured lender should use that appraisal in developing a clear bidding strategy and determining the final credit bid amount that the secured lender proposes to submit.

c. **Restructure**. In addition the secured lender should add the new 45 day delay related to the over-bid right, to its overall economic analysis in whether it would be better to restructure the loan obligation with the owner of the real property. It should be remembered that: (i) Section 2924m does not provide for any interest to be paid; and (ii) as discussed below, the ultimate owner of the real property will have to deal with the rights of any tenants on the real property.

3. **Relief through SNDA**? A question is raised below whether a Subordination Non-disturbance and Attornment Agreement might be used to have the tenant waive its rights under various tenant protection statutes. Whatever might be the answer regarding other protection statutes, C.C. 2924m does not contain a provision explicitly prohibiting a tenant from waiving its rights under that section. However, that absence is not dispositive. Such a waiver might be viewed as being void as contrary to public policy.

B. **C.C. 2924n.**

1. **Tenant's Rights.** C.C. 2924n makes it very clear that the ultimate owner of the residential real property would be subject to the requirements of all tenant protection statutes imposed on all residential real property owner-lessors.

2. **Relief through SNDA**? A question has been raised whether a Subordination Non-disturbance and Attornment Agreement might be used to have the tenant waive its rights under various tenant protection statutes. This is an open question.

ATTACHMENT D

Memorandum Re: Homestead Exemption

Date: May 27, 2021

By: Jeannine Del Monte Kowal

I. HOMESTEAD EXEMPTION INCREASE

On September 15, 2020, California Governor Gavin Newsom signed into law (AB 1885) which amends CA Code of Civil Procedure (effective January 1, 2021) and increases the homestead exemption for personal residences. The new homestead will have a baseline of $300,000 but can be as high as $600,000 based on the median sale price of homes within a particular county in a particular year.

- California Code of Civil Procedure, § 704.730
- The amount of the homestead exemption is the greater of the following:
  - The countywide median sale price for a single-family home in the calendar year prior to the calendar year in which the judgment debtor claims the exemption, not to exceed six hundred thousand dollars ($600,000).
  - Three hundred thousand dollars ($300,000).
- Significant increase from the prior maximum of $175,000.

II. ABSTRACTS RECORDED PRIOR TO AB 1885

- California Code of Civil Procedure section 703.050
  - (a) The … amount of an exemption shall be made … (1) at the time the judgment creditor's lien on the property was created…
  - (c) Notwithstanding subdivision (a), in the case of a levy of execution, the *procedures* to be followed in levying upon, selling, or releasing property, claiming, processing, opposing, and determining exemptions, and paying exemption proceeds, shall be governed by the law in effect at the time the levy of execution is made on the property.
- **Berhanu v. Metzger** (1992) 12 Cal.App.4th 445 [15 Cal.Rptr.2d 191]
  - On December 18, 1990, the judgment creditor recorded an abstract in San Diego County.
  - On January 1, 1991, the homestead exemption increased from $45,000 to $75,000.
  - On February 21, 1991, the San Diego County Superior Court executed the judgment on a home owned by Metzger.
  - On May 14, 1991, the court granted judgment debtor a $45,000 exemption and judgment debtor contends the exemption should have been $75,000.
  - Court confirmed that in accordance with Code Civ. Proc., § 703.050, the judgment debtor was entitled to the lessor exemption amount of $45,000, which was the exemption amount at the time of the lien's creation.

III. **POSSIBLE SOLUTIONS**

- **Consensual liens**
  - Code of Civil Procedure 726 (One Action) and 585 (Anti-Deficiency)
- **Guarantees**
- **Collateral**
  - Brokerage accounts, collections, etc.
- **Unconventional Collateral**
  - FIS and NYDIG
  - As of December 1, 2021 - Almost 20% of PayPal users have used the app to trade Bitcoin.
- **Assignment of a Life Insurance Policy**