By: Laura N. Coughlin and Robert Finlay

BANKRUPTCY DISCHARGE DOES NOT ACCELERATE ENTIRE DEBT

Attorneys Laura Coughlin and T. Robert Finlay explain a recent ruling where a borrower's bankruptcy discharge does not start the six-year statutory period for enforcing the entire debt.

Just days after the Washington State Supreme Court denied West Coast Servicing Inc.'s petition for review of the Division I Court of Appeals decision in *Luv v. West Coast Servicing Inc.*, Division I abruptly changed course, positively clarifying years of state and federal court's misinterpretation of their previous decision. A borrower's bankruptcy discharge does not start the six-year statutory period for enforcing the entire debt.

Since 2016, the bankruptcy discharge acceleration theory has resulted in losses for many lenders in Washington and has even found footing in other states like Colorado, Arizona, and Nevada. This article will explain how we got here and explore the spread of related decisions in other states.

HOW WE GOT HERE: THE *EDMUNDSON* DICTA

The Washington statute of limitations on written contracts and enforcement of negotiable instruments is six years. Absent acceleration, if the contract is repaid in installments, the six years runs against each installment as it becomes due. If acceleration or maturity occurs, the six years runs against the entire debt from the date of acceleration or maturity. It has been well settled law that acceleration could only be triggered through the actions of the lender, as written in the contract itself.

Initially, the 2016 opinion in *Edmundson v. Bank of America, N.A.*, appeared to merely confirm that: (a) the statute of limitations applies differently to contracts payable on demand and installments; and (b) the borrower's bankruptcy discharge did not effectively void the deed of trust and note based upon the borrower's lack of personal liability.

Quoting the 1945 Washington State Supreme Court decision, *Herzog v. Herzog*, the court in *Edmundson* wrote, "when recovery is sought on an obligation payable by installments, the statute of limitations runs against each installment from the time it becomes due; that is, from the time when an action might be brought to recover it." The court in *Edmundson* then reasoned that the statute of limitations accrued each month until the borrower no longer had personal liability under the note, i.e., the date of their bankruptcy discharge. The problem with this interpretation is that it was equating the lack of personal liability with calling the loan due, signaling that an "action might be brought to recover it" as stated in *Herzog*.

If we were to rely on *Edmundson's* interpretation of *Herzog*, then immediately upon discharge, the lender should commence enforcement proceedings, regardless of the borrower's continued payments, because the court is deeming the loan due in its entirety and accrued for recovery. Of course, taking this approach could harm borrowers who are

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trying to make good on their loan obligations post-discharge. In light of this illogical interpretation, this discussion in *Edmundson* was seen only as dicta. This is evidenced by the lack of cases after *Edmundson* arising from lenders refusing payments post discharge and initiating foreclosure based upon the borrower's discharge.

To further illustrate why *Edmundson's* unreasoned interpretation of *Herzog* should not have been relied upon, in the same opinion, the court stated, "to the extent the trial court ruled that some event during the bankruptcy proceeding triggered (the acceleration) provision, the court is wrong. Under the plain terms of the deed of trust, this is an option to be exercised by the lender, not something triggered by events in bankruptcy proceedings." Unfortunately, this confirmation of well settled law is ignored or circumvented as the bankruptcy discharge argument moved forward, gaining momentum in Washington and, eventually, elsewhere in the country.

EDMUNDSON'S BANKRUPTCY DICTA BECOMES GOSPEL IN THE NINTH CIRCUIT

Citing *Edmundson,* borrowers increasingly argued that, because they were no longer personally liable for payments after being discharged, the last payment that "became due" was the payment that immediately preceded the discharge. In other words, the six-year statute of limitations on foreclosing for nonpayment started to run upon discharge, regardless of the language in the loan agreements stating otherwise. The Western District of Washington, and subsequently the Ninth Circuit, sided with the borrowers.

In a ruling by the Western District of Washington in *Jarvis v. Fannie Mae,* the *Edmundson* dicta took flight. The court in Jarvis stated that "(b)ecause the Edmundsons owed no future payments after the discharge of their liability, the date of their last-owed payment kickstarted the deed of trust's final limitations period. (…) The holder of the deed of trust had six years from that date to foreclose on the Edmundsons' home." In the same ruling, the court in *Jarvis* stated that the opinion in *Edmundson* "do(es) not demand that acceleration automatically accompany discharge because acceleration occurs at the creditor's option when certain conditions are met." The Ninth Circuit affirmed Jarvis in June of 2018 relying entirely on *Edmundson.*

In essence, the courts in *Edmundson* and then *Jarvis* deemed the bankruptcy discharge an accelerating event, without calling it an accelerating event, while continuing to say that only lenders have the right to accelerate the debt. This became a divisive issue with Washington bankruptcy courts.

Relying on *Edmundson*, in November of 2018, debtor Nazario Hernandez commenced a bankruptcy adversary action to deem his loan time barred. The bankruptcy court dismissed the proceeding stating it was not required to follow *Edmundson* because it was dicta, that the statute of limitations is only triggered by maturity or acceleration, there was no law supporting the argument that the discharge of the note was the equivalent of maturity or acceleration, and the reliance on this position "would lead to potentially absurd results." On appeal, the Western District of Washington, citing to their ruling in *Jarvis*, overturned the bankruptcy court's ruling. The Western District did not see *Edmundson's* arguments as dicta, citing back to *Herzog* for support. This reversal was upheld by the Ninth Circuit—"a straightforward application of Washington law that the bankruptcy court was not free to ignore renders this result" while citing only to *Edmundson*.

In December of 2020, in *Brown v. Deutsch Bank N.A.* (in re *Plastino*), another bankruptcy court declined to follow *Edmundson* and *Jarvis.* This was the first time a judge calls a spade a spade—highlighting that following the *Edmundson* dicta is effectively accelerating the loan. This time, the court dug deeper into *Edmundson* to try to find out where this reasoning, which was not based upon any law, other than a reference to *Herzog,* could have originated. The court found a reference to a Western District Court case with no precedential value, *Silvers v. U.S. Bank, N.A.,* cited in lender counsel's brief in *Edmundson.* The court in *Silvers,* with only a previous reference to Herzog regarding installment payments, deemed the bankruptcy discharge an event starting the running of the clock. As this language was not supported by any law that included the effects of a bankruptcy discharge, the *In re Plastino* court dug deeper into *Silvers,* finding similar language in the lender's brief, without legal authority, stating that the statute began running at the earliest, the month before discharge. The court in *Silvers* took legal argument from counsel, removed qualifying language, and deemed that to be their interpretation of the law.

Based upon this, the *In re Plastino* court determined that the prior bankruptcy "did not cause acceleration of future installments on the note." Unfortunately, *In re Plastino* settled mid-appeal in July of 2021 so there was no substantive review of the effect of *Silvers* on *Edmundson* by the Ninth Circuit.

WASHINGTON REVISITS *EDMUNDSON* IN *LUV V. WEST COAST SERVICING INC.*

In August of 2021, Division I of the Washington State Court of Appeals had the opportunity to revisit their decision in *Edmundson* and the effect of the primarily federal cases that followed. In an August 2021 unpublished opinion, the court decided to uphold the erroneous interpretation of their findings in *Edmundson*.

In *Luv v. West Coast Servicing, Inc.,* the borrower obtained a discharge in March of 2009, made no payments after discharge, and commenced an action to quiet title free of the deed of trust in April of 2019. Relying on *Edmundson*, Division 1 ruled that "Edmundson cannot be *read* to stand for the proposition that bankruptcy discharge eliminates or accelerates the debt; rather, discharge triggers the statutory

limitation period during which a creditor may enforce the deed of trust." However, these two statements are incongruous. The triggering of the statutory limitation period on an entire debt is done through maturity or acceleration, and as the court in *Edmundson* noted, "(u) nder the plain terms of the deed of trust, (acceleration) is an option to be exercised by the lender, not something triggered by events in bankruptcy proceedings."

This "it is not an acceleration" but "does start the six-year statute of limitations clock" rationale is what was so baffling to those watching these cases unfold. Even if one argued that it was not an acceleration of the debt, but instead an early maturity, that argument fails to cure the fault in the logic. An early maturity, under well settled law, only occurs through acceleration … by the lender.

The lender in *Luv* petitioned the Washington State Supreme Court for review, but on January 5, 2022, they refused to review the issue. With this denial, we thought the Edmundson dicta was solidified as law, at least for a little while.

DIVISION I REVERSES COURSE: *COPPER CREEK V. WILMINGTON SAVINGS FUND SOCIETY*

In an unexpected move, Division I issued a published opinion in *Copper Creek Homeowners Association v. Wilmington Savings Fund Society.* Authoring the decision, the presiding Chief Judge Marlin J. Appelwick, effectively overturned all of the decisions stemming from *Edmundson* that relied upon the misinterpretation creating the bankruptcy discharge acceleration.

Referring to the lower court's reliance upon *Edmundson* to determine that the statute of limitations runs from the last payment due prior to discharge, the court states "[t] his was error. *Edmundson* did not establish such rule. No Washington Supreme Court has established such a rule. It is not the law in Washington. The federal cases, which are the source of that interpretation of *Edmundson,* are in error. To the extent that unpublished state appellate cases have repeated the federal interpretation, they are also in error."

The court reiterated multiple times that *Edmundson* did not create new law. They bolster this by pointing to the fact that the court in *Edmundson* did not discuss or review the policy implications of creating such a broad rule. "The important point is that we undertook no such policy analysis in *Edmundson* as would have been expected when announcing a new rule."

With this decision, it seems as though lenders in Washington can breathe a sigh of relief. However, there is still the possibility that either the Court of Appeals or the Washington State Supreme Court could review the issue again.

OTHER STATES, TAKE NOTE

In the wake of *Edmundson* and *Jarvis*, borrowers in other states have taken the opportunity to use the now overturned bankruptcy discharge acceleration theory to their advantage. So far, some courts in Colorado and Nevada have accepted the theory to the detriment of lenders.

Colorado: In *Silvernagel v. U.S. Bank,* the Colorado Court of Appeals unequivocally accepted *Jarvis*. Relying entirely on *Edmundson* and *Jarvis,* the court stated that "(t)he division concludes that the discharge in bankruptcy of a borrower's personal liability on a debt commences the six-year limitations period during which the bank may foreclose on the deed given as security for the debt."

Nevada: In *Ramanathan v. Bank of N.Y. Mellon,* the United States District Court of Nevada considered the effect of a bankruptcy discharge on both judicial and non-judicial options for recovery and split their opinion, relying on Jarvis for one. In the context of judicial foreclosure only, the court accepted *Jarvis* in reasoning that the ability to commence a judicial foreclosure accrued when the debtor was discharged or the court lifted the bankruptcy stay because "(a)t that point, BONY knew or should have known that it had six years to pursue a judicial foreclosure based on the breach of the note and deed of trust." While this is not precedential, as we have learned from *Silvers* and *Jarvis,* a district court ruling can take on a life of its own.

Arizona: In *Diaz v. BBVA,* Division II of the Arizona Court of Appeals refused to follow *Jarvis* based upon the lack of bankruptcy code authority modifying the effect of the discharge, and *Jarvis*' non-precedential value in light of already established Arizona case law. Quoting its decision in *Stewart v. Underwood,* the court in *Diaz* stated, "there is (no) indication that Congress intended the bankruptcy discharge to interfere with state statute of limitation. In fact, … the intent was to recognize the continued existence of the debt for purposes not inconsistent with the discharge of personal liability."

A similar matter, *Luu v. Rez,* is pending before Division I. As of this writing, Luu has not been decided but is fully briefed and under advisement as of November 10, 2021. Hopefully, a supplemental briefing apprising the court of the decision in *Copper Creek* will be submitted so that the issue can be resolved quickly.

WHAT NEXT?

The takeaway of *Edmundson, Luv,* and ultimately *Copper Creek* is that the law is never certain. To limit future issues that could arise from aged loans, lenders should enforce defaults as soon as possible where practical. If there is an issue preventing the loan from being placed into the standard foreclosure process, escalate! Whether it is a lost note, title issue, tribal land, deceased borrower, etc., discussing your options with counsel well before the statute of limitations becomes an issue will reduce exposure stemming from aged loans.

Disclaimer: The above information is intended for information purposes alone and is not intended as legal advice. Please consult with counsel before taking any steps in reliance on any of the information contained herein.

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